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BUDGET OVERVIEW

HEARINGS

BEFORE THE

COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

SPECIAL BUDGET HEARINGS

Congressional Budget Office
Department of the Treasury
Office of Management and Budget

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BUDGET OVERVIEW FOR FISCAL YEAR 1988

WEDNESDAY, JANUARY 21, 1987

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10:12 a.m. in room SD–192, Dirksen Senate Office Building, Hon. John C. Stennis (chairman) presiding.

Present: Senators Stennis, Chiles, Sasser, DeConcini, Bumpers, Harkin, Reid, Hatfield, Weicker, Cochran, Kasten, D'Amato, Specter, Grassley, and Nickles.

OFFICE OF MANAGEMENT AND BUDGET

STATEMENT OF HON. JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

OPENING STATEMENT OF CHAIRMAN STENNIS

Chairman STENNIS. Our committee will please come to order. This is a called meeting of the Senate Appropriations Committee, and our principal witness will be Dr. Miller, who is Director of the Office of Management and Budget. I have observed his work as far as I had time to on this budget, and I know his testimony would be of value to our committee at this hearing. Each member of the committee certainly is entitled to a chance to hear him testify and also ask questions themselves. We will follow that pattern here.

I am going to suggest that after the statements, we have questioning by the members and start off, anyway, under the 5-minute rule. The lady here will keep that time and will tap you on the shoulder to let you know when the time has expired. If that doesn't prove to be adequate time, we can change the rule.

I have a statement here for the committee that is not going to take a great deal of time, but it does open the door here and lays down the picture and parts that we are interested in.

This morning, the Appropriations Committee of the Senate begins the first of the overview hearings on the President's proposed budget for fiscal year 1988. Today we will hear from the Honorable James C. Miller III, the Director of the Office of Management and Budget.

On Friday, January 23, we are scheduled to hear testimony from the Secretary of the Treasury, James A. Baker III, on revenue estimates, the new credit reform proposals, the proposed deficit, deficit financing, the growing debt and the international trade deficit.

Later on in February, we will have hearings with Dr. Rudolph Penner, Director of the Congressional Budget Office, at which time he will present his annual analysis of the President's budget.

It is a privilege for me to welcome Dr. Miller here this morning, to this committee, and to these proceedings which we all view as vitally important. You have a big job, Doctor, and I commend you and your assistants for the hard work required to put together such a large and comprehensive budget in a relatively short time. We look forward to hearing your statement as it relates to the President's proposed budget for fiscal year 1988.

In a moment, I would like to make a few general comments, but first I would like to call on and ask our former chairman of this committee, who did an outstanding job, Senator Hatfield, if he would like to give a few remarks, and if so, I hope you will speak up now.

OPENING STATEMENT OF SENATOR HATFIELD

Senator HATFIELD. Thank you, Mr. Chairman. First, I would like to say it is a pleasure to welcome back before this committee to defend the President's budget, Dr. James Miller, the Director of OMB.

Yours is not an enviable task, Mr. Miller, and while I do not join with those who thought that the budget was dead upon arrival, I do think it has a great need for major restructuring and change. I intend to join with Chairman Stennis, our chairman of the Budget Committee, Senator Chiles, our ranking member, Senator Domenici, and members of both sides of the aisle to work toward producing a responsible budget that continues to reduce the deficit in fiscal year 1988 and beyond.

For that reason, I must say, Mr. Miller, I am most disappointed that the President's budget does not meet the out-year targets of the Gramm-Rudman-Hollings Deficit Reduction Act. As I recall, this administration was most enthusiastic in support of that legislation, and it is curious to me that the President would fail to even propose a budget that meets its goals while he continues to berate Congress, and particularly this committee, for what he believes to be our errant ways.

I intend to pursue this matter with you this morning and in further questions in detail, but I just merely want to welcome you at this time and make you feel at ease as much as possible. [Laughter.]

Mr. MILLER. Thank you, I think. [Laughter.]

Senator HATFIELD. Thank you, Mr. Chairman.

Chairman STENNIS. Yes, sir, thank you.

STATEMENT OUTLINE

Mr. Miller has presented a statement outline to the committee which we will insert in the record at this point.

[The statement outline follows:]

Outline of Statement to the Senate Appropriations Committee

by James C. Miller, III
Director, Office of Management and Budget

January 21, 1987

Thank you, Mr. Chairman.

I want to express my appreciation for your remarks, those of Senator Hatfield, and the remarks of others on the Committee.

Mr. Chairman and Members of the Committee, today I would like to:

- -- describe a few themes and details in the budget,
- -- go through the materials I submitted in advance and which are displayed in the charts before you, and then
- -- answer your questions.

Themes and details of the budget:

- -- As with last year, the emphasis in this year's budget is on deficit reduction:
  - -- The deficit dragon is not slain.
  - -- But last year we extinguished the dragon's fire,
  - -- And this year we will cast a net over the beast!
- -- This year's budget contains:
  - -- A 3 percent increase for Defense, but
  - -- No tax increase, and
  - -- No change in Social Security benefits.

One budget theme is the funding of some emerging priorities; for examples:

- -- Drug program initiatives -- reducing supplies and increasing enforcement, prevention and treatment ($3 billion)
- -- Immigration reform (extra $400 million)
- -- Acid rain/clean coal (extra $350 million over 5 years)
- -- Federal Aviation Administration (extra 20 percent overall; 68 percent increase for Air Traffic Control modernization)
- -- Infant mortality ($85 million)
- -- AIDS (extra $533 million -- 28 percent increase)
- -- Homeless

The budget also has a number of new programs, projects and approaches; for examples:

- -- Credit reform

- -- Pay for performance/productivity
- -- Revisions in the Farm Bill
- -- Two-year budget for Defense
- -- Aid to Families with Dependent Children/youth

Another budget theme is to realize a more productive, competitive America; for examples:

- -- Increase knowledge and education:
  - -- Double the National Science Foundation research budget in 5 years
  - -- Increase DOD/NASA research and development by $7 billion
  - -- Reform education support to:
    - -- Make more unobstructed guaranteed loans available to students, and
    - -- Provide income-contingent loans to financially disadvantaged.
- -- Make the private sector and the economy generally more efficient by:
  - -- Increasing efforts to improve technology transfer,
  - -- "Privatizing" commercial-type government activities, and
  - -- Being less intrusive with government regulation where possible.
- -- And, make government do its part by:
  - -- Increasing productivity, and
  - -- Instituting prices for specific services with user fees and loan fees.

Still another theme of this budget is to reform the provision of health care in this country; for examples:

- -- Reforms in Medicare:
  - -- RAP (radiologists, anesthesologists, and pathologists) proposal ($660 million savings over 5 years),
  - -- Payout cycle (increase the length of the cycle from 26 days to 30 days, at a savings of $890 million),
  - -- Remove disproportionate share hospitals from periodic interim payment system.
  - -- Expand coverage (mandatory) of current state and local employees under medicare ($1.6 billion), and
  - -- Increase Part B premium from 25 percent to 35 percent for new medicare enrolees.
- -- Reforms in Medicaid ($1.3 billion) that we think will continue to deliver the benefits, but at lower costs:
  - -- Reduce state support by $1 billion.

-- Index future payments to Medical Consumer Price Index.

-- Capitation incentive initiative (increase match), and

-- Regulatory reforms.

-- VA medical reforms (outlays will be higher in FY 1988 than in FY 1989):

  -- Services would be provided to categories A and B (98 percent of applicants).

  -- No funding would be made available for category C veterans, but care for these veterans could still be provided where resources remain available ($170 million savings).

Now, Mr. Chairman, if you will, I would like to describe briefly the major parameters of the President's budget with the aid of the charts you see before you.

(A copy of these charts was provided to each Senator on the Committee.)

QUESTIONING BY SENATOR BUMPERS

Chairman STENNIS. Gentlemen, I shall proceed to be fairly brief. If anyone has an emergency and you want to be heard for a few minutes, a very few, we would be glad to hear from you.

Senator BUMPERS. Mr. Chairman, I would welcome that opportunity. I do have to leave in just a moment, and if I could just ask the Director a couple of questions before I leave?

Chairman STENNIS. Suppose I give you 2 or 3 minutes.

Senator BUMPERS. Something like that, or less.

Chairman STENNIS. I recognize you for that purpose, and the same thing for you, Senator.

Senator WEICKER. No questions.

PREDICTED GROWTH RATE

Senator BUMPERS. Mr. Miller, my State constitution requires a balanced budget. When I was Governor, we always wrestled with that, but I found as the chief executive, if one just mixed the projections around, one could always project a balanced budget. Now, you have reduced our projection for growth rate in 1987 and 1988 from what you had projected last August.

My first question is, No. 1, why have you done that; and No. 2, how on earth do you think you are going to achieve a 3.7 percent growth rate?

Mr. MILLER. Well, it's a very difficult thing to estimate for in advance, and as we come——

Senator BUMPERS. Let me make one other observation. I understand that each one point you miss the growth rate by increases the deficit by almost $20 billion; is that correct?

Mr. MILLER. I think that is the estimate.

Senator BUMPERS. Nineteen to $20 billion is, I think, what we used.

Mr. MILLER. That is still high.

Senator BUMPERS. That is still high? Go ahead.

Mr. MILLER. We haven't done that exactly, but I think that is high. It is difficult to estimate growth rates. As you get more information, you get a better fix on what the economy is likely to do. As we get closer to the year we are estimating we get a better fix. Sometimes it means we raise the estimates; sometimes it means we lower the estimates. As you point out, we go from 4.2 percent growth for 1987 and 4 percent in 1988 down to 3.2 percent for calendar year 1987, counting fourth quarter over fourth quarter, and 3.7 percent for calendar year 1988.

We think that these are the best estimates right now, the most likelihood, maximum likelihood estimates. The most recent information that has come to pass since the budget went to print January 5, tends to support that. The leading indicators are up; housing is up; other things are up. I think that we——

OMB/CBO ESTIMATES

Senator BUMPERS. Why are you and CBO so far apart on this?

Mr. MILLER. We are actually not so far apart. For calendar year 1987, fourth quarter to fourth quarter, they are 3.0; we are 3.2. That is two-tenths of 1 percent apart. For fiscal year 1988—excuse me—calendar year 1988, however, they are at 2.9 and we are at 3.7, so the divergence for 1988 is much greater.

Sometimes OMB underestimates growth; sometimes it overestimates growth.

BLUE CHIP ESTIMATES

Senator BUMPERS. Is the 1988 budget where the widest divergence is, between you two, according to the paper this morning?

Mr. MILLER. Yes, that is true.

Senator BUMPERS. The second question——

Mr. MILLER. May I just point out, Senator, if you look, for example, at what are called blue chips, about 50 forecasting groups report to blue chip and the forecasts have a fairly broad range. We are just above the middle of that range at the present time, but certainly within the bounds of reasonableness.

Senator BUMPERS. Could you furnish this committee with a list of those blue chip estimates?

Mr. MILLER. Surely.

[The information follows:]

BLUE CHIP ESTIMATES

The Blue Chip consensus is the average of fifty-one private forecasts. These forecasts fall over a fairly broad range. The consensus projects the annual rate of growth for real GNP to average 2.5% in 1987. However, the top ten forecasts in the consensus average 3.6% whereas the bottom ten average 1.0%. The Administration's 3.1% forecast for 1987 falls well within that range. The long term Blue Chip consensus was last compiled in October 1986. That compilation showed the consensus real growth projection to average 3.3% for 1988. The Administration's 3.5% real growth forecast for 1988 is just above that average. A list of the Blue Chip projections for real growth in 1987 follows. (For comparability with the Administration's forecast, the December Blue Chip projection for 1987 is used.)

BLUE CHIP INDICATORS -- DECEMBER 10, 1986
FORECAST FOR REAL GROWTH IN 1987
(percent change; year over year)

Source:	Real GNP
Bostonian Research Associates	4.3
Prudential Insurance	3.9
Polyconomics Incorporated	3.8
Marine Midland Bank	3.6
Morris Cohen & Assoc.	3.5
E.I. DuPont Company	3.5
LaSalle National Bank	3.5
Irving Trust Company	3.4
UCLA Business Forecast	3.4
Fairmodel-Economics Incorporated	3.4
Cahners Publishing Company	3.3
University of Michigan M.Q.E.M.	3.3
Harris Trust Savings Bank	3.3
Wayne Hummer	3.2
Econoviews International Incorporated	3.1
Inforum U. of Maryland	3.1
Econoclast	3.1
Charles Reeder Assoc.	3.0
Brown Brothers Harriman	3.0
Sears Roebuck	2.9
Bankers Trust	2.8
Chamber of Commerce of U.S.A.	2.7
Manufacturers Hanover Trust	2.7
Northern Trust Company	2.6
Equitable Life Assurance	2.6
Eggert Economic Enterprises	2.6
Pennzoil Company	2.6
U.S. Trust Company	2.6
First National Bank - Chicago	2.5
Security Pacific National Bank	2.5
National City Bank of Cleveland	2.5
Dean Witter Reynolds	2.5
Morgan Guaranty	2.5
Morgage Bankers Association	2.5
Philadelphia National Bank	2.3
Peter L. Bernstein	2.2
Bank of America	2.2
Chase Manhattan Bank	2.1
Conference Board	2.1
Meyer and Associates	2.1
Evans Economics	1.9
Merrill Lynch Economics	1.9
Metropolitan Insurance	1.8
Georgia State	1.8
Morgan Stanley and Company	1.8
Chrysler Corporation	1.7
Arnhold and S. Bleichroeder	1.6
Siff, Oakley, Marks, Inc.	1.3
Prudential Bache	0.0
Arthur D. Little	-0.7
Business Economics, Incorporated	-1.0

Source: Blue Chip Economic Indicators, Vol. 11, No. 12, December 10, 1986; Robert J. Eggert, Editor, Eggert Economic Enterprises, Inc., P.O. Box 1569, Sedona, AZ 86336.

Memorandum: Comparison of Administration's Real Growth Forecast
with Blue Chip Consensus
(percent change; year over year)

		1987	1988
Administration's real growth forecast............		3.1	3.5
Blue Chip Summary	Average...........	2.5	3.3
	Top 10 average....	3.6	4.3
	Bottom 10 average.	1.0	2.3

EXECUTIVE DEFERRAL OF SPENDING

Senator BUMPERS. Second, did you see where an appeals court has ruled that the President doesn't have the right to defer spending, and if so, how does that affect your projections for 1987 and 1988?

Mr. MILLER. Yes, Senator, we are aware of the decision by the U.S. Court of Appeals of the District of Columbia with regard to the question of the legislative veto in the Impoundment Act. As you know, there was a presumption on the part of Congress that the legislative veto, one-house veto was constitutional when the Act was passed and signed into law by President Nixon.

Since then, there has been the Chadha decision and subsequent litigation before the Supreme Court, which has concluded definitively that the legislative veto, one-house veto, in particular, is unconstitutional.

The question that the court faced was whether, under the guidance given by the Supreme Court in the Chadha decision, the legislative veto could be separated or severed from the body of the law itself.

The severability has been interpreted both as meaning whether as a technical matter it can be read separately and also the more intriguing question of whether Congress would likely have passed the law if it understood at the time the legislative veto was unconstitutional.

The court, the District Court of Appeals, concluded that Congress would not have passed the law and therefore, that provision is unconstitutional. Now, whether the Department of Justice will appeal that decision has not yet been determined. So I apologize.

DEFERRALS

Senator BUMPERS. What of total deferrals over here? That is my question. Suppose the Supreme Court upholds this decision?

Mr. MILLER. The court did stay its judgment, but even if it did not stay its judgment and we were bound by the court's present decision at the moment, it would only have a de minimus effect on the President's budget in terms of the outlays for fiscal year 1987.

I think there is a couple of hundred million dollars, $300 million (the exact amount is $258 million), approximately, at issue.

Senator BUMPERS. Total?

Mr. MILLER. A total, $300 million (the exact amount is $258 million) in policy deferrals. We have deferral authority under the Antideficiency Act, as well. What is at issue is whether the President can defer moneys for policy reasons seeking, at some subsequent time, to have those moneys overturned through a rescission or whatever.

That is what is at issue, and as, in accordance with an understanding and discussions we have had with the leadership here, the President's budget, save for moneys to finance, essentially, the pay supplement, the pay increase that became law at the first of the year, moneys for which the Congress demanded that there be a pay increase but did not appropriate, there were no policy deferrals. That is the reason the amount of money is so small.

I apologize for the length of my answer.

Senator BUMPERS. Mr. Chairman, thank you very much.

Chairman STENNIS. Thank you. Gentlemen, do you have something now, sir, you want to ask? I think we better go back to the regular form here, and we will get to members as fast as we can. If you have a few words, we can take out 5 minutes for you.

Mr. Miller, someone has said that you were going to address yourself to these boards and signs and so forth, but I am disappointed if you don't have a written statement here, and I hope you will file one sometime soon, an overall statement of your plans and what you are going to do and what the situation is.

Often, the testimony is very valuable, but with the conditions here, the interruptions come, it is not the best chance to get fully what you are saying. We need something in writing. It doesn't have to be long.

HIGHLIGHTS OF FISCAL YEAR 1988 BUDGET

Mr. MILLER. Mr. Chairman, I have submitted in advance a document which points out the highlights of the President's fiscal year 1988 budget. What I would like to do is discuss briefly from notes some of the major highlights of the President's budget and then discuss them with the aid of charts. I apologize for not having a longer prepared statement, but Mr. Chairman, we have been working our fingers to the bone. This event is occurring sooner than the budget was produced last year. We do have a number of additional documents, the budget appendix, the special analyses and other documents we are still preparing and anticipate being able to release on January 28.

Chairman STENNIS. I am not laying any blame to you at all. We want this to be one of your better years, and I believe it would be a mighty good investment for you to give us this overall statement as to what you perceive and what you are going to do, and then you can notify us of any change later. It is not written in stone.

Mr. MILLER. All right.

Chairman STENNIS. I believe that will pay off. You will need some more time.

Mr. MILLER. Yes.

Chairman STENNIS. But you will get that together.

Mr. MILLER. I will be glad to give you a written statement.

Chairman STENNIS. All right. Let me finish this statement here, following Senator Hatfield's, which this statement itself is fairly brief, and you can then start with your discussion with the charts.

CONTROL OF FEDERAL BUDGET DEFICIT

We are certainly at a critical period in the process now of bringing the Federal budget deficit under control. We are faced with some very difficult choices, choices that must be made if we are to move ahead with the plan we have initiated to reverse the trend of increasing budget deficits.

I think you and other members of the administration know of my personal commitment to deficit reduction. I have said, and I continue to believe, that we can bankrupt this Nation but, but—I emphasize that to strengthen and underscore and underline that—that is the very thing that we are not going to let happen. I do not believe that we will allow bankruptcy or near bankruptcy of our system of government because we know that that is the beginning of some kind of collapse, and any kind of collapse is a serious one.

I recognize these things, though, these bad things as real possibilities. We must not be slow in recognizing that.

I have favored a fair and gradual approach to deficit reduction which would bring about the desired results without inflicting special hardship on any particular segment of our population, that is, as far as is as reasonably possible. I have honestly felt that every portion of the budget should carry part of the reductions which are necessary. After all, we have a commitment to all the people to keep our Nation strong and viable. Nobody wants America to become a second-rate nation.

MILITARY BUDGET

Our military superiority is, of course, imperative. I hope that I have never been a fanatic on the subject, but I have always stood for a strong defense capable of defending our interests around the globe. Defense is a basic function of government, and I have always tried to do my part in seeing that our men and women wearing the military uniform have been fully equipped and that our defenses are the best.

I do not hold any attitude or thought that our defense should be allowed to fall behind any other nation's military. We must not allow that to happen. But I do believe we need to take a hard look at the amounts we are spending for defense and determine whether there is some room for savings. I believe that something can be done in that field.

I have also believed that we can make the dollars we appropriate for defense spending go further, further than now, if we develop an approach which requires greater accountability.

Now, those are serious points, and they are not easily handled. I am not making any accusations or anything like that of mishandling funds, but I know what it means to try to the utmost to try to make a dollar go further. I know what the short phrase means when you say, "Get along on less." I know it the hard way.

So I think the time has come now. We are adequately armed under present conditions. The time has come now for us to press harder to get more out of that dollar and more return. That in and of itself is a very strong sign, convincing evidence, that we are not to be taken for granted. That is a sign of strength as well as military weapons themselves. That is a determination to make things come out sound.

EDUCATION FUNDING

In the field of education, I am going to be very brief here, but I know that there is a lot more to our strength as a nation than military might. Education, educational training, not just in a few fields, but is essential in all fields. This is an absolute necessity.

At a time when competition from foreign countries is stronger than ever—and I never thought I would see it in my time, as strong as it is now, this competition—are we going to say that we have given too much emphasis to education in the past and that we should now reduce our commitment? This seems highly unwise and unsound to me. I challenge this budget on that point with every bit of the strength that I have.

ECONOMIC DEVELOPMENT

In the field of economic development, I am concerned. It is something that I know a great deal about, but when you put it alongside of other things that go to make up our economy and make our living for our people that are not what we call well fixed, then this economic development in importance and necessity stands right beside agriculture production and other reductions of that type and kind.

There are other essentials involved in keeping this Nation strong and competitive. This Government must respond to the needs of the people. We cannot turn our backs on the towns and communities struggling through changing economies. Some that have been heavily dependent on agriculture and others that have relied on the oil and gas industry are suffering from a severe lack of opportunity in this, the land of opportunity.

Some are hit harder than others by the harsh realities of stiffer foreign competition, such as communities where many people are employed in textile plants. We cannot turn our backs on these people in their time of need.

I am not advocating handouts here, but I am standing up for the economic development programs of our Government that represent the only hope for some communities in their efforts to attract new industries to provide jobs for their people.

I might yield on some things, as to my conclusions, but I am not going to yield on that one, because I live and I have always lived right in the middle of an area of this kind, including the agriculture, as well as the small economic unit productions. These are the programs that are necessary to help people help themselves.

The people who fill these jobs pay taxes and are productive citizens who give back to the Government in so many ways.

I have said that this is a great time to be alive and in a position of leadership. The opportunities we have, working together, are unsurpassed. Our challenges are very severe. We will face many difficult choices as we work toward limiting the deficit this year. I didn't say eliminating, I said limiting this year. Priorities must be determined and held to that will assure us of continued strength in every area.

To accomplish this, it is important for all involved to meet every deadline in this budget process so that the final result is the passage of the 13 separate appropriations bills by October 1. In order to avoid the committee's massive catch-all Continuing Resolution, we need the time for each subcommittee to resolve the difficult questions which they will face in this fiscal year.

CONTINUATION OF APPROPRIATION PROCESS

I have never been outstanding in the field of appropriations, but I have been on the Appropriations Committee a good number of years. We have had an outstanding man, Senator Hatfield, as chairman of this committee. But the idea of pitching 10 or 12 or 13, what would have been that many appropriations bills all into the hopper, all into one bill, the Continuing Resolution or any legislative device of that kind, and moving them all along together is to destroy, is to destroy one of the main and highly important segments of the U.S. Senate.

I think when I came here, it was after World War II had ended, that the operations of the committee, as I observed then, on the floor of the body, was one of the best performances that I have found any time during all these active years. Since then, we had larger and larger problems and budgets.

I will never give in on letting the appropriations process that we have known up until now, never give in to let it be destroyed or grossly modified for a permanent role. We have got to maintain its identity, and we have got to maintain its capacity, and we have got to maintain its independence of other pressing matters that the Senate will have to consider.

I said the other day, when we had the first meeting of the committee, as I saw things, these 29 members that we have on this committee, that I can't find any place in any other government anywhere in the world that occupies a more important, a more powerful position in government, than do those 29 members. That is my opinion; that is my judgment. I believe I can prove it, and it is a fact of life. We just must not put the normal business of the Congress in supplemental bills and wrap it up with the appropriations process.

There are other problems, and I am supporting the budget law, and supporting the things that are necessary to go with the whole package.

I think to reach all these results, I mean a balanced budget, though, in 2 to 3 or 4 years, that the people ought not to be told to expect that. But I hope we will resolve in our mind that being the immediate holders of this power, vested with this power to which I have referred as being so great and far reaching, I hope we will hold on and be sure that we preserve for posterity and for our system of government this method of getting at the problems of the Nation's budget and then acting according to the best judgment we have.

I am not trying to outlaw supplemental appropriations. We have to have some of that, but there is no reason to appropriate such large sums of money unless it deals with some unanticipated problem which was impossible to predict. I hope we will be prepared to deal with that problem when it develops.

DEFICIT TARGETS

I have about completed my part of my remarks now. The President has presented us with a budget that meets the 1988 budget deficit target of $108 billion. This budget, however, misses the deficit target set for 1987, 1989, 1990 and 1991.

Moreover, the balanced budget in 1991 contemplated in the Gramm-Rudman-Hollings Act is not achieved. It is postponed until the succeeding year. We need not agree with all the details of the 1988 President's budget submission. We must keep in mind, however, that any deficit reduction proposals that we reject must be replaced by some other proposal of equal savings.

If we do not, we will not achieve a fiscal year 1988 deficit target of $108 billion or less. Let us take this budget proposal which has been submitted in earnest and combine our best efforts to formulate a budget for 1988 that will direct our limited financial resources to the best use for the continued strength and vitality of our Nation and also sets a path for future budgets that will continue the reduction of this deficit.

This is a good place and time to begin that process, and I am sure that the members of this committee are anxious to contribute to the process.

Dr. Miller, we really do look forward to continuing to hear from you as you prepare and send us the President's budget submissions, and our efforts will be certainly in line with you, always, and our conclusions will be somewhere in the same neighborhood, I am sure.

Dr. Miller, as I understand, prefers himself to refer to the charts and point out certain things about them. Then we can get to questioning here by the membership. I am a great believer in the members having a chance to ask questions, but let's hold our questioning to 5 minutes for the first round.

Senator Hatfield, I defer to you, and I always appreciate your remarks. Do you have some questions now that you need to ask, or do you want to proceed with your charts now, Dr. Miller?

Mr. MILLER. Unless Senator Hatfield has something pressing.

Senator HATFIELD. I have an 11 o'clock meeting, Mr. Chairman, but I would like to hear from Dr. Miller.

Chairman STENNIS. All right. Let's proceed here with the charts now. We will get to the questioning later.

OPENING REMARKS OF JAMES MILLER

Mr. MILLER. Mr. Chairman, let me thank you for the opportunity to appear before you. I wanted to thank you personally for the cordiality and the professionalism with which I have been received by you and your staff on these matters, and I look forward to working with you.

I would also like to pay tribute to former Chairman Hatfield, with whom we have worked so thoroughly during the last year, and I look forward to working with you as well, in the future.

I would like to describe briefly a few themes and details of the budget and go through the charts and then answer your questions. As of last year, the emphasis on this budget is on deficit reduction. As I indicated once before, or at least once before, the deficit dragon isn't slain, but I think that we will bring him under control this year.

The budget contains a 3-percent real increase for defense; no tax increase; and it doesn't touch Social Security benefits.

BUDGET PRIORITIES

One theme of this budget is its emerging priorities. Drug enforcement is a priority. Reducing supplies of drugs, emphasis on people consuming less drugs, and also treatment. Drug initiatives are about a $3 billion program in this budget. Immigration reform, we propose $400 million in total budgetary increases to help carry out the responsibilities under the immigration bill.

We have an extra $350 million for clean coal technology; a 20-percent increase in FAA funding for air safety; and an $85 million program to reduce infant mortality. We propose a 28-percent increase in the amount of funds for AIDS research. This is a terrible, terrible disease, and we have, for the first time, proposed over one-half billion dollars be devoted to this issue. That is about the maximum we think the scientific community can logically assimilate.

We have a program for the homeless. We have a number of programs in the credit area and we propose to pay Government employees on the basis of performance and productivity increases. We propose changes in the farm bill; a 2-year budget for defense; some modifications to the Aid for Families With Dependent Children Program.

We propose initiatives that will help us realize a more productive, competitive America and will increase knowledge and education. We will double the NSF research budget in 5 years; increase the amount of research going to NASA and DOD. We will make some reforms in education.

We will make the private sector and the economy generally more efficient by increasing our efforts in technology transfer, by privatizing commercial-type activities and by being less intrusive with Government regulations, where possible, and we will make Government do its part to increase productivity. We propose, also, that there be user charges for commercial-type activities.

HEALTH CARE PROGRAMS

Another theme in this budget is health care. We have some reforms in Medicare, to pay radiologists, anesthesiologists, and pathologists through a privatization-type program. We propose to increase the payout cycle from 26 days to 30 days. We propose to remove so-called disproportionate hospitals from the periodic interim payment system and to put them on the same basis as other hospitals.

We propose to expand coverage of current State and local employees under Medicare, and we propose to increase the Part B premium for new Medicare beneficiaries from 25 percent to 35 percent. We propose modifications in Medicaid that we think will continue to deliver the benefits but at lower cost, and we have some proposals for changing and adjusting VA, as well.

CHART PRESENTATION

Now, Mr. Chairman, with your permission, I would like to go to the charts and go over them briefly and hopefully finish in time to respond to Senator Hatfield.

Chairman STENNIS. All right.

[CLERK'S NOTE: The charts referred to by Mr. Miller will appear following the submitted questions and answers at the conclusion of the hearing.]

BUDGET HIGHLIGHTS

Mr. MILLER. Perhaps I can just do this without the aid of a microphone. Let's look at this chart (Slide 1). As I indicated, the highlights of the President's budget are that it meets the Gramm-Rudman-Hollings target of $108 billion. It does not increase taxes. It provides a 3-percent real growth for defense. It does not touch Social Security benefits but proposes some $19 billion in programmatic savings for fiscal year 1988.

As you correctly point out, the President's budget does not hit the Gramm-Rudman-Hollings targets in the outyears, but I would make mention of the fact that the Gramm-Rudman-Hollings law requires the administration propose a budget that meets the Gramm-Rudman-Hollings target only for the year of the budget, which is fiscal year 1988.

Obviously, in subsequent years, we would need to make some additional changes and modifications, working with Congress, in order to meet those outyear targets.

Under the President's budget (Slide 2), receipts will continue to rise over the period 1986 through 1992 fiscal years. Outlays would continue to rise as well, remaining relatively flat, and then beginning to turn up in the outyears.

The resulting deficit falls and hits the target for fiscal year 1988, while remaining slightly above the target in the outyears (Slide 3). The line here is the Gramm-Rudman-Hollings target.

Chairman STENNIS. Dr. Miller, let me ask you, what do you put in the record now? What is going to show up in the record as these charts here?

Mr. MILLER. I will submit for the record this document, which is a copy of all of these charts. I am illustrating this for you rather than going through the document itself. I will also submit——

Chairman STENNIS. So your information ties in and the big chart and the explanation in the small book, they tie together?

Mr. MILLER. Yes, sir. Absolutely.

Chairman STENNIS. All right.

Mr. MILLER. Then I will also submit a written statement for the record as you requested.

OUTLAYS AND RECEIPTS

This chart (Slide 4) demonstrates outlays and receipts and the derivative deficit over the period 1970 through 1992 and shows that receipts have generally rocked along 18 to 19 percent of gross national product, whereas outlays realized a substantial increase as a portion of gross national product, partly in response to the recession that we experienced in the early 1980's. It was then that the deficit was at a maximum in terms of proportion of gross national product. It declined in 1984 and rose again in 1985.

In 1986, it was actually a slightly smaller proportion of the gross national product, even though the nominal deficit was at an all-time high, $221 billion.

This chart also shows that we anticipate the deficit will continue to go down to reach a balanced budget, zero deficit.

MAJOR BUDGET COMPONENTS

This chart (Slide 5) shows the major components of the budget from outlays from 1986 through 1992. We can distinguish four general categories: Net interest; Social Security; national defense, and everything else. Net interest we cannot really do anything about without declaring bankruptcy, in a sense, as you were suggesting, Mr. Chairman, not that you were suggesting bankruptcy. [Laughter.]

As you pointed out, it would be the unwise course.

Social Security, there is sort of a bipartisan agreement we don't touch that, and this chart shows a 3-percent real increase for national defense.

This leaves, Mr. Chairman, a base of about $416 billion in all other Federal programs, from which we will suggest programmatic changes in order to make some savings so we can get down from the $150 billion current services deficit to the $108 billion figure. That is $42 billion, as I will indicate a little later. A little bit less than half will come from programmatic savings.

This chart (Slide 6) shows the defense budget in constant dollars, the budget authority in dollars, and as you can see, contrary to what some people have indicated or is a widespread belief, the defense budget peaked in 1985 and in real terms has actually gone down for 2 straight years. For fiscal years 1986 and 1987, the defense budget authority in real terms was actually less than in 1985. Even under the President's budget, it will take 2 more years to return the defense budget authority back to the level in real terms that was experienced in 1985.

Mr. Chairman, I second the argument that you made, the very valid point that you made earlier. We must look for waste and fraud and abuse in every area of Federal Government, in defense, as well as everywhere else.

You have my commitment to do that, as well. We do think, however, that the progress that we have made in the Packard Commission report and others enables us to have the strong national defense that we need on only a 3-percent real increase.

DEFENSE BUDGET

As a proportion of Gross National Product, defense outlays fell from a high during the Korean conflict, peaked again during the Vietnam conflict; and then fell, I think, to much too low a level as a proportion of Gross National Product in the late 1970's (Slide 7). They rose slightly under President Reagan, again, as a proportion of Gross National Product, but most importantly, under the President's proposed budget, will decline as a proportion of Gross National Product.

Mr. Chairman, I would like to stop right here, if I could, because I don't want to miss Senator Hatfield's questions.

Chairman STENNIS. Yes.

Mr. MILLER. But I can respond to him and then return to this. Would that be most convenient for you?

Chairman STENNIS. Yes. Senator Hatfield, I would like to call on you at this point.

Senator HATFIELD. Thank you, Mr. Chairman.

Thank you very much, Mr. Miller. I appreciate very much the opportunity to lay before the committee a couple of questions.

EFFECT OF GRH ON PRESIDENT'S BUDGET

First of all, I need not review in detail the history that you and I both know so well, and that is that I consider the Gramm-Rudman-Hollings as a dodge at a real issue, even though it was well-motivated and sincerely offered by my colleagues and voted for by my colleagues. To me, it did not give us the solution nor did it let us do other than postpone the ultimate decisions we will have to make.

But once it is signed into law, I very much believe in my oath of office of upholding not only the Constitution, but all the laws thereunder, and so I am most anxious to see the Gramm-Rudman-Hollings Act observed and obeyed.

Mr. Miller, your budget that you presented here or the President's budget you presented purports to meet the Gramm-Rudman-Hollings target for 1988 of $108 billion, and I use the word "purports" because I believe that the preliminary estimate by the CBO says that it falls short or that the President's budget is understated by $27 to $32 billion.

I understand that the major part of this difference is perhaps what we might call in the field of technicians' arguments and economic assumptions. We had that example last year when we were talking about the so-called defense outlay estimates.

But these technical or whatever these estimates may be called have very serious policy implications, as I am sure you will agree.

Mr. Miller, I don't believe this committee or the Budget Committee or the general public will long tolerate this arcane argument between OMB and CBO on economic assumptions and technical reestimates of outlays. Let's, for the moment, assume that the CBO is only half right. That would mean that this committee will have to find about $15 billion more to meet the deficit reductions necessary and created by the Gramm-Rudman target and as recommended by your budget presentation here today.

My question is, basically, do you have any ideas or proposals of how this committee should meet that more realistic target that I have indicated that I believe we will face ultimately before we complete the appropriations process, such as a laundry list for further program terminations or asset reductions or asset divestments or perhaps even additional revenues, whatever is necessary?

RECOMMENDATIONS FOR MEETING $108 BILLION TARGET FIGURE

What do you suggest that we do in this as we face the reality of finding further reductions to meet that target figure of $108 billion?

Mr. MILLER. Senator Hatfield, let me say first and stress that the CBO figures are very preliminary and tentative. I have a copy of Dr. Rudy Penner's letter to Chairman Lawton Chiles of the Senate Budget Committee, and he says, "Our preliminary analysis, therefore, is fairly rough and subject to change. We are not able, have not been able to get details on a number of administration proposals, and there are a number of other questions relating to differences between CBO baseline projections and OMB current services estimates."

This year is an anomoly in that, as you know, we were put in a position where we could not possibly, with Congress adjourning in October and leaving 170 more bills for us to go through, we simply could not possibly produce with the budget on January 5, the normally associated documents. The leadership asked the President that we do our best, and the President told me to produce as much as we could.

This means, however, that a lot of the budget details CBO simply does not know, does not have access to. I can imagine their being fairly conservative, in a sense, in not presuming that the proposed substantial cuts and programmatic changes lead to as much of a reduction in outlays as we claim. I guess if I were in Rudy's shoes, I would probably be doing the same thing.

So I think it is important to await CBO's final reestimate of the President's budget before we embark on any kind of assumption that the number Congress will have to deal with, the CBO number, is as high as the initial preliminary estimate.

As to what we might do by way of greater deficit reduction, should that be the case, at that time, I think I would be more than happy to work with Congress to suggest additional programmatic changes, additional sources of revenue, revenue not of a tax variety, but of a kind and type that we have in the budget in order to close that gap.

But I think at this point, Senator, it is a bit premature to make the assumption that the number that the Congress will have to deal with will be substantially different from that presented by the President.

ADMINISTRATION FAILURE TO ADDRESS DEFICIT

Senator HATFIELD. Mr. Miller, I gave OMB the greater benefit of the question in being a preliminary estimate by saying if they were only 50 percent right. Let's say they are only 5 percent right, or are you prepared to say that there is only a 90 to 10 percent possibility they are right at all?

I would like to really point out, again, that I have considered Gramm-Rudman a shell game. As long as this administration refuses to face up to the real issues that this deficit is a composite of spending, of entitlements and of underfunded revenues, and when this administration will only be willing to face that one small part of the problem, namely, in discretionary spending, and there, a very limited part of discretionary spending because military is sacrosanct, that we are really either engaged in a game of self delusionment and also attempting to delude the public into believing we will ever balance the budget on, basically, what turns out to be about a $170 billion baseline out of a one trillion, one hundred billion dollar budget.

I don't think that in this presentation or at any other point that the administration should go unchallenged with its utter and complete failure to meet the problem of the deficit. That is all you can call it when it constantly is going up.

Now, I understand that as a fiscal conservative, I look at it perhaps in a little different light than those who have one of the great spenders of this Nation's history, Mr. Roosevelt, as its political hero. That puts it down into the realm of a historic perspective, but I just do not believe that we can say that this $108 billion is anywhere realistic, and I am just merely saying that whether you are prepared today or whether down the road, let us, this committee, start out being very honest and very forthright in recognizing that we aren't going to meet the Gramm-Rudman-Hollings requirement by this budget that has been presented here.

Whether we miss it by $5 billion, $15 billion or $10 billion, we are going to miss it, or are you prepared to tell me that we are going to make it under the presentation you have given this morning of this budget, we are going to really have any, what percentage of possibility we are going to have to meet that $108 billion target.

Would you give me an estimate, a ball park figure, a percentage, a gamble?

Mr. MILLER. Well, I, as a professional economist——

Senator HATFIELD. That is what I am asking for.

Mr. MILLER. I realize there is a distribution of likely outcomes, and this figure is the maximum likelihood estimate. Since it comes very close to $108, I would say the chances are barely over 50-50 that we will meet it. But I want to stress that is a technical point.

Senator HATFIELD. I appreciate your frankness.

STANDARD DEVIATION

Mr. MILLER. The question is what the standard deviation is around that number. The standard deviation is probably reasonably large, probably $10 billion, around that estimate. That is a technical matter. But when you come out, say, with an estimate that the Gramm-Rudman-Hollings does not give you a ban or a range, does not, say, come in $10 billion or one epsilon, one standard deviation below the figure, it says come in below that figure, and is our maximum likelihood estimate.

Any substitution will tell you when you are making projections, you have some kind of uncertainty, and what you try to do is acquire the right information and know what the universe looks like in order to plot that frequency.

Senator HATFIELD. In other words, we are perhaps within a $10 billion range of missing the target?

Mr. MILLER. Well, I will say, I mean, again, we have comported with what the law requires. But I think anybody who tells you that they know what the number is going to be, whether it is the deficit or total revenues or total outlays, and says that they are absolutely sure of it has got to be something other than a professional.

Senator HATFIELD. What percentage of assuredness are you?

Mr. MILLER. By definition, one standard deviation means that I am .67 percent sure that it is plus or minus $10 billion. That is just a—that is a very technical, academic thing, but the law requires us to come in under $108, and that is what we have done. That is the maximum likelihood estimate.

SUPPORT OF GRAMM-RUDMAN-HOLLINGS

Senator HATFIELD. Yes, and I admire you for standing by the law and what you have been done here today, but Mr. Miller, let me point out, this administration pounded the drum and blew the bugle in support of the Gramm-Rudman. It was going to answer our deficit problem, in all sincerity, I am sure.

But having done more than just comply with the law, I think you have a moral obligation in this administration to make sure that this Gramm-Rudman-Hollings is realistically handled and assessed.

I don't, frankly, think it has been in meeting, in giving this budget here of $108 billion target that I think is, again, as the old saying goes, is a lot of smoke and mirrors. I would like to submit further questions on this, because the chairman has very fairly outlined a procedure here this morning that I will violate by furthering my questioning at this time.

But, Mr. Miller, I look forward to working with you in the realm of realism in dealing with this budget, and I do hope that we can continue bipartisan, in a bi-branch government. In other words, it takes both the Executive and the Legislative. Some of my questions have to do with congressional bashing on budgets and on spending, and I think that has got to be moderated, too, before we reach the ultimate goal that we both seek in getting some kind of control over this deficit.

Chairman STENNIS. All right, gentlemen. Thank you very much. We do have a promise out about getting to these other gentlemen who have been very considerate. Excuse me just a minute. Any amount of time that either one of you want, that is what you will get. But if we can suspend now and let me redeem some understanding that we had with the other members, I am not sure which one of you gentlemen has been here the longest. You will be the next one we call on.

Senator D'AMATO. Thank you, Mr. Chairman.

Chairman STENNIS. Mr. Miller has a word or two to say in response. All right, Dr. Miller.

GRH EFFECTIVENESS IN REDUCING DEFICIT

Mr. MILLER. Mr. Chairman, I wanted to first respond to Senator Hatfield. I think actually, Gramm-Rudman-Hollings has been quite effective in reducing the deficit. The deficit for fiscal year 1986 came in at $221 billion, and under the first year of Gramm-Rudman-Hollings, it so happens that OMB and CBO are practically dead alike in our estimate of $173 versus $174 billion deficit for fiscal 1987. That is a $48 and $47 billion reduction in just one year.

Senator HATFIELD. Which is $29 billion over the target.

Mr. MILLER. Which is $29 billion over the target, and as you know, Senator, there are reasons for that. First of all, everyone understood last October that the target was really $154 billion, because built into Gramm-Rudman-Hollings was a $10 billion margin of error.

Secondly, with the Gradison baseline, there were rules under which we as well as CBO had to make estimates which accounted for about another $10 billion. Finally, we have had some deterioration in the economy which accounts for another $10 billion, so that is the reason the number is high.

I think as Senator Rudman said before the hearing of the Budget Committee, the important thing about Gramm-Rudman-Hollings is continuing the downward slope in the deficit rather than hitting specific figures.

CBO/OMB BUDGET ESTIMATES

Could I also point out, Mr. Chairman, that CBO and OMB in the past have had some substantial disagreements on their estimates of the deficit. For the fiscal year 1982 budget, CBO estimated a $67 billion deficit, and we, OMB estimated $45 billion, which was a 48.9 percent difference. In 1983 there was a 27.9 percent difference.

In 1984, OMB estimated a deficit of $189 billion and CBO estimated $176 billion. We estimated higher than the CBO for a 67.9 percent difference. The differences have not been so large in the last 3 years and this year I stress the preliminary estimate is a 27 percent difference. So I do not think there is anything in particular that marks this year's difference between the CBO and OMB on that.

Mr. Chairman, if I could finish up this presentation very quickly?

Senator HATFIELD. Thank you, Mr. Miller.

Chairman STENNIS. Thank you. I am not going to limit your time, of course, but you are speaking in terms of now, what do you want, 10 minutes, say?

Mr. MILLER. Probably 5 minutes, Mr. Chairman.

Chairman STENNIS. Beg your pardon?

Mr. MILLER. Five minutes.

Chairman STENNIS. All right. Let's give the gentleman 5 minutes. The Senator from New York will be next.

Mr. MILLER. Thank you very much.

Chairman STENNIS. All right, you may proceed, Mr. Miller.

ENTITLEMENTS

Mr. MILLER. This chart (Slide 8) divides up the remaining part of the budget into three areas, major medical, other mandatory, which are non-discretionary programs, and non-defense discretionary. I wanted to point out to Senator Hatfield that, in fact, the President's budget does, of the $19 billion in cuts, find $10 billion in the major medical and other mandatory areas.

In other words, entitlements do come in for a $10 billion programmatic reduction under the President's budget for current services.

HEALTH CARE PROBLEMS

We have a very difficult situation in health care in this country (Slide 9). We spend a much higher proportion of our Gross National Product on health care than any other industrialized country, and health care cost inflation is growing at a much faster rate than inflation.

We do not see any substantial differences in the quality of health care. Longevity is just the same here as it is in other industrialized countries. In fact, infant mortality is, unfortunately, higher here than in other industrialized countries.

The President's budget (Slide 10) essentially calls for a pause in the rate of growth in Medicare, Medicaid, and other medical programs, and then a return to an increase but not at as great a rate as before in current services.

OUTLAYS FOR MANDATORY PROGRAMS

Outlays for other mandatory programs (Slide 11) have gone up and down over the years. The President's proposal, for some of these other mandatory programs, calls for a reduction of more than the current services reduction, partly because Commodity Credit Corporation outlays will be less, and then a resumption of an upward tilt in outlays.

In the non-defense discretionary programs (Slide 12), the President's budget essentially calls for a slight rise over time instead of the rather substantial increase under current services.

I would point out that under the President's budget, $18.7 billion of programmatic changes are envisioned. Savings toward the deficit of $42.4 billion is needed. The rest of the savings come from, first, lower interest expense of $1.3 billion, the reason being that with the lower deficit, you have lower debt to carry and the interest exchange will be lower, and then an assortment of revenue measures raising $22.4 billion.

As you can see, of the deficit reduction program, (Slide 13) revenue changes account for 53 percent; debt service reduction for 3 percent and the programmatic changes account for 44 percent of the President's deficit reduction program (Slide 14).

The details of the reduction program by revenues and by outlays or programmatic changes are indicated on the final chart (Slide 15) in the volume I submitted in advance that you have before you.

Now, Mr. Chairman, I would be glad to respond to any other questions.

Chairman STENNIS. Thank you. Thank you very much.

As I understand, now, any member of the committee that has any questions on these matters, if they are unable to find what they are looking for within your charts and so forth, you will supply it?

Mr. MILLER. Yes, sir.

Chairman STENNIS. This will help you and it helps the committee.

Mr. MILLER. I would be glad to, Senator.

Chairman STENNIS. I am glad to recognize the Senator from New York. We are running under the 5-minute rule, not rigidly applying it, but I call it to your attention.

WAR ON DRUG TRAFFICKING

Senator D'AMATO. Mr. Chairman, I thank you, and I am going to make an observation. I recognize that the Director of the Office of Management and Budget, Mr. Miller, does not have an easy job. It is probably an impossible job, given the Gramm-Rudman restraints and requirements, to come in with a budget that meets our national defense needs, that meets the target, and also that has as a caveat no tax increases to increase revenues.

But I do have some serious concerns with respect to an area of the budget that, it seems to me, only 2 months after an election we seem to have forgotten about. Republicans and Democrats and the administration should all be deeply concerned about this matter, and that is the so-called war on drugs. I have to say to my friend, Jim Miller, and I consider him a friend, that the administration's fiscal year 1988 budget proposal is a retreat in that war.

You cannot on one hand say that we are going to have a 3-year program and then, under various techniques, begin to defund that by saying, "Well, it was a one-time expenditure."

This budget, no matter how you look at it, reduces our effort to bring about drug education, drug rehabilitation, and drug enforcement by $900 million.

I find it totally unacceptable. I have supported every single defense initiative to the point that I have been criticized, and maybe with some justification, because I believe in a strong national defense. But I have to share with the people from OMB and this committee my feeling that the defenses of this Nation are not adequate as it relates to that battle against the insidious evils of drug and alcohol abuse. We are losing that war, and that if it means that we do not move to a deployment for a Strategic Defense Initiative, I want to assure the administration and this committee that unless those dollars for these drug programs and the Customs wing are restored that, believe me, this Senator will have no difficulty in making that choice, and it will be to restore the dollars for those important drug programs.

I did not work for the comprehensive drug control bill to find that funding for education programs was going to be viewed as a one-term or 1-year situation. I can't justify it, and I think that there is going to be an outcry when people begin to find out the details of how these programs have been curtailed or cut back. I hope there will be an outcry, and I hope that members, my colleagues on both sides of the aisle are as justifiably concerned today as they were pre-November election time with respect to the problems of drugs and drug abuse.

DEFERRAL OF FUNDING FOR AIR INTERDICTION PROGRAM

I leave you with one question. It has been indicated, Jim, that there was going to be a curtailment of some $51 million for the Customs air interdiction program on drugs. Is that deferral still going forward, or has the administration decided not to try to defer those dollars?

Mr. MILLER. It is not a deferral. We have some reprogramming of funds for air interdiction. The Drug Policy Board, as you know, has met a number of times. What we are trying to do is put together a comprehensive program, and ask, of the funds that we have, how can we make those go the furthest, and the southwest border, as Senator DeConcini knows, is going to be funded in full.

In the other areas, we are going to have the funding, as well. The question is what combination of Aerostats or P–3's or other kinds of aircraft makes the most sense in that area.

So we are proposing reprogramming, or at least I have been assured by my staff that it is not a matter of deferrals, but a matter of reprogramming. If I could respond to your statement, Senator D'Amato, on the war on drugs and ending essentially, abruptly, ending the war on drugs, nothing could be further from the truth.

ELEMENTS OF WAR ON DRUGS

The war on drugs encompasses, really, three items: One, reducing the supply of drugs; secondly, reducing the propensity of people to consume drugs; and thirdly, treating those with drug disabilities. That program was $1 billion in fiscal year 1981. That program was $2 billion in fiscal year 1986.

The President concluded that more needed to be done. We needed to have a war on drugs, and the dimensions of that proposal were several: One, he proposed to increase the funding from $2 billion to $3 billion; secondly, he proposed that that funding emphasize the so-called demand side, that is, reduction of consumption of drugs.

In accordance with that, the President indicated that the war on drugs needs to be fought by more than simply money. It needs to be fought by encouraging people, as the First Lady said, to "Just say no," to encourage others to engage families and friends in the effort to reduce overall drug consumption.

The Congress, in its passing of the drug bill, got into a bidding contest as to who would spend the most money and came up with a $4 billion program. Now, the President's budget for fiscal year 1988 proposes to go back to the $3 billion that the President asked for, which is a 50 percent increase over fiscal year 1986.

I need to stress again that the war on drugs will not be won simply by putting more money on this issue. It is a matter for families, for schools, for friends and everyone else. Besides that, I think it is a matter also for local law enforcement agencies.

As you know, the Federal Government spends a very large proportion of its law enforcement resources on drugs. State and local governments spend a minuscule proportion of their budgets on drug enforcement.

LAW ENFORCEMENT CUTS

Senator D'AMATO. Mr. Chairman, if I might, I know we have been cautioned to 5 minutes, and I would just like to respond by saying this: It is a cut. The President signed a bill that provided for $3.9 billion. We are cutting $900 million, $503 million in law enforcement.

Law enforcement cannot afford that cut. They were just beginning to gear up, and they looked forward to using these resources for this year and the following years; drug abuse prevention, down by $199 million. That is education and prevention. By God, if you are going to break the syndrome, you have got to have treatment facilities, and you have got local jurisdictions that simply just don't have the wherewithal, and they need those Federal dollars. For an addict, who wants to come in and get rehabilitation, to be told, "I'm sorry, you have got to wait 6 weeks or 8 weeks or 10 weeks," and that is what is going on throughout the metropolitan areas of this Nation, is just not acceptable, and that is what is taking place.

It is not acceptable, and we are cutting drug abuse by $211 million.

So let me simply say, from my perspective, and I see Senator DeConcini here and Senator Specter who I know are concerned, that this cut is unacceptable. There are other areas, and maybe even perhaps that I have supported in the past that may have to be trimmed, but this is an area where we cannot afford to cut. If anything, in my opinion, we would have to increase funding in these areas. That is the way I see it.

Chairman STENNIS. All right, Senator. We want to thank you for your testimony. Your points are well made.

Gentlemen, I am still recognizing the members in the order they come in, and Senator Specter, you are next to be recognized. We recognize you for 5 minutes. If you need additional time, we can add a minute or two.

Senator SPECTER. Thank you very much, Mr. Chairman. I will not exceed 5 minutes. It will take some cooperation from Mr. Miller.

Mr. MILLER. I shall try, sir.

VETERANS PROGRAM CUTS

Senator SPECTER. Mr. Miller, I have held a series of hearings in Pennsylvania: Harrisburg, Wilkes-Barre, Scranton and Allentown, seeking inputs from Pennsylvanians about the budget cuts, and I have had, just to start—I am going to be doing it in other places as well—great concerns about the cuts in the veterans programs, on senior citizens.

Two lines have been especially problemsome, although there are many that are problemsome to an extent, and the two lines that I would inquire of at the moment are the impact of the cuts in education on scholarship programs and on the impact of subsidies for urban mass transit.

In Allentown, on Monday of this week, an official from Muhlenberg College gave me a projection as to what was happening with guaranteed student loans and also with Pell grants, and I would be interested to know whether the administration has any projections as to what has happened with the cuts heretofore and what would happen with projected cuts on Pell grants and guaranteed student loans in terms of reduction of students who can afford to go to college.

[The information follows:]

GUARANTEED STUDENT LOANS AND PELL GRANTS

The administration does not believe that its proposed student aid reforms would reduce the number of students who can afford to go to college. Although the number of aid awards and number of students aided would be reduced, these reductions would primarily be in the form of small awards to wealthier students. Pell grants for virtually all poor students would be maintained at current maximums and aggregate federally generated aid would be held roughly at levels occurring in recent years. (Details may be found on p. I–I14 of the 1988 Budget Appendix.)

We anticipate that students will adjust to any reductions in Federal aid by various combinations of increased work, increased borrowing, and less costly education. We do not anticipate any aid-related reduction in college enrollment.

EDUCATION QUESTION

Mr. MILLER. Senator, let me just address the education question. We have such estimates. We would be glad to share them with you. I don't have them at my fingertips, but let me say, there are two types of estimates. Look, I am a former educator. I have a Ph.D., and I taught in several colleges and universities, so it is not as though education is not important to me, personally.

But basically, there are two kinds of support. First, there is financial support for higher education that the Federal Government engages in. Some is to support universities, research, et cetera. The other is indirect support through the funding of students.

In turn, there are two types of funding for students: First, there are direct grants, Pell grants and other kinds of little grant programs; and secondly, there are guaranteed loans.

The difficulty of a child going to college——

IMPACT ON STUDENT LOAN PROGRAMS

Senator SPECTER. Mr. Miller, we don't have much time. I know the difference between guaranteed student loans and Pell Grants. My question is, what is the impact? If you don't know it at the moment, I would like an answer later.

Mr. MILLER. The impact is that the total amount of funds outstanding for students to go to school is going to be just about the same this year as last year, but at a savings of $2.4 billion to the taxpayers because we are moving toward income contingent guaranteed loans and the regular guaranteed student loan program and away from the outright grant program.

Senator SPECTER. Mr. Miller, we only have 2 minutes. I will abide by the time limit. I don't agree with what you have just said about the equal availability of funding on the tuition grants. What I would like you to provide to me, and to I think other members of the committee I think would be very interested in, is what has the impact been on reduction of scholarship availability for cuts in the past 5 years, and what is the projection for this year?

I have asked colleges to respond specifically, and I will share that information with you.

Mr. MILLER. Fine.

[The information follows:]

STUDENT AID REDUCTIONS

Because the Congress has consistently failed to enact the administration's proposed reforms for Education Department student aid, there has been no significant reduction in Education Department scholarship availability (Pell Grants, Supplemental Educational Opportunity Grants, State Student Incentive Grants) in the past 5 years. The only reductions have come through (a) the Gramm-Rudman-Hollings reduction of 4.3 percent in all grant programs in 1986, and (b) estimated underappropriations for the Pell Grant Program in 1982 and 1986, requiring a reduction in awards by the Secretary. (There were similar Pell reductions in 1980 and 1981 for the same reason.)

The Congress has, according to Department estimates, again underappropriated funds for the Pell Grant Program this year in an amount of $62 million. The 1988 budget proposes a transfer of unneeded Guaranteed Student Loan [GSL] funds to finance this 1987 short fall and the accumulated prior year shortfall of $225 million as well. If this transfer is not approved, the Secretary will again reduce grant awards in order to live within amounts appropriated.

SUBSIDIES REDUCTION FOR MASS TRANSIT

Senator SPECTER. But I would also like to know with respect to what the impact is going to be on the reduction of subsidies for mass transit, and the predictions that I have heard in the Dauphin-Cumberland-Harrisburg area, and also in North Hampton, Lehigh, Allentown, Scranton and Wilkes-Barre are just absolutely disastrous.

[The information follows:]

MASS TRANSIT

Over one-half of our proposed cut in mass transit funding results from the elimination of the discretionary program, under which only 20 large cities received 80 percent of the funds. Therefore, in the smaller cities such as those cited, the proposed reduction is much smaller than the aggregate reduction. Under our proposal these small cities (those under 200,000 population) will retain the flexibility to use their apportioned funds for either capital or operating expenses; we are not proposing any reduction in their operating assistance caps. We do not expect major cutbacks in service resulting from the proposed reduction. Even small urbanized areas have the potential for benefiting from the competitive selection of service providers and other actions to improve productivity. Such cost savings would reduce the need for operating subsidies. Our proposed elimination of the outmoded Section 13(c) requirement should help them achieve these savings. In addition, many of these areas need to examine their route and fare structures to rationalize the services they are providing and the share of costs recovered from users. Many transit operators currently hold many more vehicles than are required to meet their peak service schedules, indicating that capital replacement needs may be reduced over the next few years.

Moreover, carryover of unobligated formula funds has been a recurrent problem in the transit program, especially among the smaller size cities. At the end of fiscal year 1986, the areas below 200,000 population carried over a total of $253 million, equivalent to 140 percent of their fiscal year 1987 apportionment. This indicates both the possibility that these areas have been funded beyond their needs and the existence of a cushion that is available to the Governors to make funding adjustments. The Governor of Pennsylvania had $12.9 million of such flexibility as a result of his carryover, which is 150 percent of the fiscal year 1987 apportionment for small areas in that State.

DEFERRALS OF APPROPRIATIONS

Senator SPECTER. We have 1 minute left. I could at least formulate the question. That is, I would be interested to know what the imposition is going to be in response to the decision by the Court of Appeals for the District of Columbia Circuit which is reported in the media today saying that you do not have the power to defer the appropriations which Congress has legislated. Are you familiar with the decision?

Mr. MILLER. Yes, Senator. I responded to a question by Senator Bumpers on that in rather some detail. A decision has not been made to appeal the ruling. As you know, there is a statutory basis for deferrals other than the Impoundment Control Act and this is the Antideficiency Act. The question of so-called policy deferrals, if any, are limited in the 1988 budget to those routine kinds of policy deferrals that were accepted in the past without question to finance the pay supplemental, before the supplemental was acted on. The pay increase that was mandated at the beginning of the year by Congress, for which Congress did not appropriate additional funds is only about $300 million (the exact amount is $258 million).

Senator SPECTER. Mr. Chairman, I yield back the balance of my time.

Chairman STENNIS. Senator, you are very generous. Let me comment: 5 minutes may not be enough time when you have got something here that is important. Dr. Miller has an important matter on the same subject. We will get a better time limit here started, gentlemen. Were you through?

Mr. MILLER. No, sir, Mr. Chairman. I will be glad to give you additional information, Senator Specter, if that would be satisfactory. Otherwise, I will answer now.

Chairman STENNIS. If you would, Mr. Miller, I would appreciate it if you will provide your information for the record.

Senator SPECTER. Mr. Chairman, I will review the testimony given to Senator Bumpers, and then perhaps a following question on your approach on rescissions and deferrals, et cetera.

Chairman STENNIS. Gentlemen, the 5 minutes is really not enough time for discussion of these subject matters. We will get a better time limit if I have to. We don't want to cut anyone off here. There is a vote scheduled for 4 o'clock.

All right, gentlemen, Senator Cochran, I recognize you now. Please observe as much of the 5-minute rule as you can.

REFORM IN APPROPRIATIONS PROCESS

Senator COCHRAN. Thank you very much, Mr. Chairman. Mr. Chairman, when I was in high school, our senior class put on a play, and it was described as a farce in three acts. This budget process today reminds me of such an event, except I think I would describe this as a farce in two acts.

First, the administration—not just this administration, but the previous Carter administration, and before that, the Ford administration and earlier administrations, comes up with a budget proposal which they know is not going to be approved by the Congress. Much of what is in the budget really ends up being changed by the Congress, and it is known well in advance that it is not going to be approved by the Congress.

What happens in the second act takes place here on the Hill. The Congress goes through a process of hearings, at which time administration witnesses are badgered and pushed around at hearings and criticized for the proposals that the administration makes. Then, what comes out of the Congress—a budget resolution, if one is ever agreed to under the processes—is also a joke, because then the appropriations process ends up superseding that. In my judgment, Mr. Chairman, this indicates that we are in desperate need of a reform package—a package of changes in the law and in our procedures, that makes better sense out of this process.

I don't think any individual, either in the administration or the Congress, is really to blame for this, but the process is flawed to such an extent that neither the administration nor the Congress has any credibility in the budget process any longer. I think it is time we addressed that as a need for comprehensive budget reform.

There have been several proposals that have been made. I prefer that we consider seriously a 2-year budget cycle as an example of an improvement in the process. Having a joint committee on the budget in Congress, to me, would be preferable than the system that we have now.

It might speed up the consideration and the approval of a budget resolution by the Congress if we could start off working as a conference committee rather than as two disparate groups in the House and the Senate. The line item veto and the Constitutional amendments are ideas that this administration has pushed very hard. I have supported both of them, but neither is going to be passed.

So I don't think that we can hide behind rhetoric about procedures and changes in the law which we know are not going to take effect and are not going to be approved by the Congress. There is, I think, a need to differentiate between capital expenditures and operation expenses in a budget, because there are different economic implications of those kinds of expenditures.

I recall when President Carter suggested that that change ought to be made. He was ridiculed and harshly criticized by many in Congress for trying to hide the deficit.

Mr. Chairman, this deficit is too big to hide now. I suggest that maybe the administration take a look at the Carter proposal, maybe rename it or dust it off and reshape it, but it should seriously consider making that a part of a proposal for comprehensive budget reform. I think a task force or a commission or a special committee should be considered. It should include representatives from the administration, the Congress, and the private sector. It would pull together the various proposals that have been made from time to time by this administration and by members of Congress, and see if there cannot be a package proposed for comprehensive reform of this process.

There may be other changes that I haven't thought of this morning or I haven't mentioned this morning which have great merit and would really be improvements in this process. But I really think, Mr. Chairman, that continuing along this present course is risking economic ruin for our country.

I hope we can see some action this year, not just posturing or more fingerpointing, in an effort to address this very serious problem.

Thank you, Mr. Chairman.

Chairman STENNIS. All right. Dr. Miller, I propose to give you time to respond to that, but let's consider what we have here. There are votes this afternoon, either three or four votes scheduled already. But they do not start until 4 o'clock. That gives us a chance to finish today.

Do you want to respond now to Senator Cochran?

Mr. MILLER. Yes, Mr. Chairman.

I endorse the thrust of Senator Cochran's comments. I think we do have to have some budget process reforms. As to my culpability in the current farce, I appreciate his exoneration, and I ask for his pardon, as well.

Chairman STENNIS. All right, gentlemen. Thank you.

Senator DeConcini, you are next.

Senator DECONCINI. Mr. Chairman, speaking of the budget process, the Senator from Florida has a very important budget meeting. I would be glad to yield to him and then take my turn afterwards.

Chairman STENNIS. Very good. Senator Chiles, we are glad to have you here; you may proceed.

Senator CHILES. Thank you, Mr. Chairman. Thank you very much, Senator.

UNDERESTIMATING THE BUDGET

I just want to touch on one thing. I understand that Senator Hatfield has already had a little discussion with you, Dr. Miller, about the CBO letter of yesterday which estimates that basically, your budget is about $30 billion off.

I understand your statement is that they are operating on preliminary data now; they don't have total details, and we are talking about a change in estimates. Well, obviously, there will be more data forthcoming when we get all of the details, and at that time, they will make a more refined statement as to where we are.

I think it is interesting that CBO, the Congress, and OMB have all been underestimating the deficit. When we left here, we thought we were within $150 billion of the deficit, so we were well within the Gramm-Rudman-Hollings target of where we had to get $144 billion. In the brief period between the time we left and the time we have come back, we see the deficit is not $150 billion but $175 billion. I think both CBO and OMB have agreed to that number, and that number is not due to strange actions that Congress took, but because we were $11 billion off in the estimate of revenues, $4 or $5 billion off in what the farm programs were going to cost, so it was due to the optimistic estimates that we take.

The fact that we have been doing that, both OMB and CBO, for a number of years certainly leads me to think that your numbers are optimistic. We agreed that we would not use a particular word that conveys a high level meeting, sometimes referred to that starts with an S, that we weren't going to use that term, so we won't use that term.

Mr. MILLER. You mean ends with an S?

Senator CHILES. So I will be careful not to use that term, but it seems to me that it is a time of renewed need if the administration's plan could be as much as $30 billion off and we would only be reaching a $135 billion deficit rather than $108 billion. If you assume that we are going to follow the law of Gramm-Rudman-Hollings, it is the law now, and that you do have to get to a deficit of $108 billion, a sequester of $30 billion would be a disaster for priorities that the Congress and the administration think are tremendously important.

If you look at what that would mean to defense, what that would be doing to all of these areas, is this not a time? The Senator from Mississippi is talking about a need to get all the parties together to figure out a process. Processes are good, but I have been watching a lot of processes.

METHODS TO REDUCE DEFICIT

The Budget Act was a process that was supposed to get the deficit down to zero; it hasn't. Gramm-Rudman-Hollings was a process that was supposed to get it down; it hasn't. The Constitutional amendment to balance the budget is a process. We haven't got it passed yet, but if we do, it will be 4 or 5 years before it comes into operation, and I assume we will find some way out of that dilemma, that trap, too, if we don't have the will.

So I would say to my good friend from Mississippi, the fastest way you can get this thing operating on track would be if you could get the President and the Congress in the same harness as to what they want to do. We can meet all the processes and we can meet all the goals. We won't have any problems with it. But without an agreement no matter what process you put up, we will find some way to get around it or get out of it. That is what we have been doing.

So I just renew my plea that we find some way. The fact that you said that there may be a 50-50 chance that they are wrong, that is a heck of a gamble, if it is 50-50. If the coin comes down tails rather than heads and they are right and you are $30 billion off, we would have a disaster on our hands if that was to happen.

So I would just urge you, again, to see if the leader won't call us together and let's see if we all can't get in harness.

Mr. MILLER. Well, Senator, let me respond first to the last point, and that is, I am always reluctant to respond to a question and give an academic answer, because I think you weren't here, and I am sure that the information you have was passed on to you second-hand, because it so easily can be misunderstood.

It is a technical matter. Whenever anyone makes an estimate, you are, by definition, looking for the maximum likelihood of something, and there is a distribution of the outcomes and that maximum likelihood estimate.

Almost by definition, if you come to a number that is close to the number of this target, the chances are 50-50 that it is going to fall on one side or the other. The question is the standard error around that estimate, and I said it was plus or minus $10 billion.

But Gramm-Rudman-Hollings hinges not only on the ex-post, that is, not only what happened. Gramm-Rudman hinges on what the estimate is. I will not change the estimate, because I think our estimate is correct.

If there were a sequester, I would just point out that the sequester, at least under current law, would be based on extrapolating what is in Gramm-Rudman-Hollings or survived under the Synar opinion. It would be the average of the OMB and CBO numbers, so it wouldn't be $30 billion, even if CBO's number is $30 billion higher.

I stress again, CBO's estimate at this point is a very preliminary one. As for the why, when you left you thought the number was $150 billion and now it is $174 billion, I think without question, and I believe, as I indicated publicly at the time and if you will examine the papers that we sent up as well as CBO sent over, under the Gradison baseline, scriptures as to how we had to make the Gramm-Rudman estimate for 1987, it means that our estimate was lower than what we would have estimated if we were simply making a forecast at that time. That cost us about $10 billion.

So it was the $144 billion figure that was the operable one, because any number over that was the estimate that would trigger a sequester. Beyond that, there is roughly $10 billion because the way the Gramm-Rudman-Hollings law reads influenced the way we made the estimate, and then above that is about $10 billion deterioration in the economy since we made those estimates back about early October.

Senator CHILES. I heard all that, but I didn't hear anything further about my renewed plea.

Mr. MILLER. Well, sir, as Mr. Chairman, as you and as we discussed in the Budget Committee hearings, I am more than happy to work with you. The President is more than happy to meet at an appropriate time to discuss this.

As you know, the leadership meets with the President very frequently and budget issues, among other issues, are raised at that time.

We have produced a budget that meets the law, that meets our estimate of what the budget deficit will be. I have heard a lot of criticism of the President's budget. Obviously, there are members of the Congress that have different ideas as to what the budget ought to be.

It seems to me perhaps it is more appropriate at this point for members of Congress who differ with the President to put on the table what they think the budget should be. Actually, if I were you, I would be very shagrin with the CBO numbers coming in, because it simply means that you have much more work to do in meeting the deficit target than you might have otherwise.

I think you should wait and see how the CBO estimates the President's budget. I think the numbers will probably come down for the very reasons that Rudy points out in his letter, and I think it will be important to see what others might propose. I think, too, without question, a lot of ground work will have to be laid for such a summit meeting.

Chairman STENNIS. All right, gentlemen. I have questions left here for the record.

Senator DECONCINI. Mr. Chairman?

Chairman STENNIS. Yes, I am going to come back to you.

Senator DECONCINI. Thank you.

Chairman STENNIS. I have questions from other Senators for the record. I ask unanimous consent that these questions presented by Senator Weicker, a member of this committee, be placed in the record at the conclusion of the hearing. Is there objection? Hearing none, it is so ordered.

CUTS IN VETERANS BENEFITS

Chairman STENNIS. Senator, I recognize the Senator from Arizona, who has been very patient to wait.

Senator DECONCINI. I want to thank the Chairman for having these hearings, and I agree 5 minutes is a short time. Dr. Miller, I have a number of questions that I will ask forebearance of the committee and yourself and ask unanimous consent that they be just presented to you and your staff, and if you would answer them?

Chairman STENNIS. You are understanding we are not rigidly following the 5 minutes.

Senator DECONCINI. Yes, I do, Mr. Chairman.

Dr. Miller, as we have discussed before, I am a critic of the President's budget in some areas, and the areas I wanted to follow up on are two: One is the veterans cuts. I note that the budget you proposed contains a rescission of $75 million for the VA health care system which would be achieved by a staffing reduction of 1,400 during the current fiscal year.

As you know, Congress has attempted to keep staffing levels for the VA health care system constant over the past few years. In light of this clear intent that I suspect you concur with from the congressional intent concerning these staffing levels, why do you continue to send a proposal that you know Congress is going to reject?

Mr. MILLER. Senator, let me go back to answer your question and respond also tc an implication of the statement made by Senator Cochran. The President's budget is not one that is designed to maximize the likelihood of Congress' adopting by acclamation.

This is the President's budget. We are not technical robots down there trying to put together a budget that we perceive that everybody is going to endorse. The President's budget is a budget that reflects his priorities and also what he thinks we can accomplish and how best to run the government. He is the chief executive.

As far as these workload things, yes, Congress has added them back, but we see a decreasing work load.

Senator DECONCINI. In the veterans?

Mr. MILLER. Yes, overtime, and we believe we can reorganize those offices and provide those services at some reduction in total manpower.

Senator DECONCINI. Because, as you may know, Dr. Miller, we went through this before you were OMB Director, and one year, while you were here, we did not have to handle a cut in health care cuts from veterans, but every other year we have. Every year Congress has put them back, and we haven't seen corrections in the VA, because they have testified before the committee that they can't do what the OMB suggests they can do.

The priority is wrong, but I appreciate your position. Your priority is that veterans can take a health care cost cut and they can lump it.

CUTS IN DRUG AREA

In the drug area, Dr. Miller, it is interesting to note that the select committee on the views of the President's budget shows without a doubt that the President has beat a hasty retreat from the highly visible support of the congressional drug bill last October.

State and local drug law enforcement assistance grants have been eliminated from this budget. Drug education funding has been cut in half from this budget. Drug treatment money provided in the bill for fiscal 1987 has been spread out over 2 years. Customs air interdiction funding has been cut by 50 percent and as you and I discussed, Customs staffing has been targeted for a $39 million rescission in fiscal 1987.

International narcotics matters funding for the drug source countries and transshipment countries has been cut by more than 16 percent. Now, it seems to me that although the administration has requested additional funds for FBI and DEA, those two agencies did not receive the amount of increases in the drug bill as the above agencies did.

My question to you is clear and simple, Dr. Miller, why is the administration backing off its public support for the Omnibus Drug Bill provisions only 3 months after signing it into law?

Mr. MILLER. Senator, first of all, the Department of Justice is one of the few agencies that is getting a very substantial increase in funding from 1987 to 1988, due to both the drug bill and the immigration reform bill, but also due to a decision by the President to increase funding for, as you have indicated, FBI agents and others.

As I responded to a previous question, the drug effort of the Federal Government was a $1 billion program in fiscal year 1981, and by 1986 it was $2 billion.

Senator DECONCINI. Excuse me. I was here when you made that, and I don't mean to interrupt you or be cute about it.

Mr. MILLER. Yes, sir.

Senator DECONCINI. I appreciate what the Government has done in the past, but when President Reagan signed the drug bill—about 10 months before—he was quoted as saying this is the number one national security matter. He signed this bill, and then his budget comes in with the cut that I outlined.

How do you rationalize a committment to a war on drugs when I don't think we have ever had a war on drugs. And how do you answer the question, why is the administration backing off the public support for the omnibus drug bill?

Mr. MILLER. Senator DeConcini, number one, because the President signs a bill does not necessarily mean for all time he is committed to every jot and tittle in the bill. That has never been the case.

AIR INTERDICTION PROGRAM

Senator DECONCINI. Do you mean to tell me he is not committed to the air interdiction program that is included in the drug bill?

Mr. MILLER. What he is committed to is what he has proposed in the fiscal year 1988 budget.

Senator DECONCINI. That is something new, then, because the President has said some very strong things about this bill, that he supported it, and then I believe he was quoted as saying we are going to follow this bill and we are going to win the war or something to that effect.

So you are telling me now that his position has changed. Fair enough, if that is the administration's position.

Mr. MILLER. I don't think that is what I said.

Senator DECONCINI. Didn't you state that the President doesn't necessarily follow everything in the bill or is committed to everything in the bill? Obviously he is not committed to the drug air interdiction program.

Mr. MILLER. I am saying as a generic matter, that to my knowledge, no President has ever said that once he or she signs a bill, that commits them forever to every jot and tittle in that bill.

The President of the United States, President Reagan, has on many, many occasions specifically demurred to certain parts of the legislation. As I indicated earlier, he had proposed a $3 billion bill the Congress presented him with, which was a 50 percent increase. The Congress presented him with a $4 billion bill, which he signed. It was a very difficult thing, as you probably remember.

In the heat of the battle over how much could be put in the bill, it was a very difficult thing to get Congress to scale back despite repeated representations by members of the administration that certain amounts were not needed.

The President's fiscal year 1988 budget is absolutely consistent with the positions that the President has taken on this measure for at least the time that I have been working as Director of OMB.

Senator DECONCINI. I want to say, Mr. Chairman, that it points out very clearly to me that number one, when the President did come up with his $3 million bill, it was only after the Republican leadership in this house and the Democratic leadership in the House of Representatives came up with bills. I am very disappointed, Mr. Director, as we discussed before, that the President of the United States wants to be the leader on drugs and uses the media in a very opportune way to demonstrate his commitment, and then he sends up his OMB Director and his budget indicating that, "Well, we are just not going to follow all this because it is not in our priority."

To me, it is an affront to the public, it is an affront to Congress, and really, it is an affront to the credibility of the administration if they really want to fight drugs. In my judgment, they are not doing it.

Thank you, Mr. Chairman.

Chairman STENNIS. Thank you, Senator.

All right, Doctor, do you have something further that you wish to say? I have a few questions here that were left to be answered.

Mr. MILLER. No, Mr. Chairman. We will respond to your request for a written document and answer the other questions and follow up any questions you wish to submit to us, to me, for the record.

Chairman STENNIS. I don't know of anyone else that is coming to ask questions. Is there any information further about this? No. Well, for this sitting, anyway, we are almost through.

U.S. COMPETITION IN WORLD ECONOMY

I have a question here I will direct to you. This is my question. One of the major concerns of Congress and the administration this year centers around America's ability to compete in the world economy. Although virtually every suggestion for improvement in this area includes upgrading our educational system, this budget proposes to reduce existing education programs by $5.4 billion, or about 28 percent, with substantial cuts in college assistance and outright elimination of Federal support for vocational education.

Dr. Miller, how can you justify a cut of this magnitude when we all recognize the need to improve education in America? I believe the pressure for it, the need is immediate. What is your response?

Mr. MILLER. Mr. Chairman, first of all, of the total amount spent on education, the portion spent by the Federal Government is very small, and we would anticipate the total amount of resources going to education continuing to rise over time.

VOCATIONAL EDUCATION

Vocational education is a case in point. Less than 10 percent of the total amount of money spent on vocational education comes from the Federal Government. It is our estimate that this program, on the part of the Federal Government, has not been an effective expenditure of the taxpayers' resources.

While the total outlays for education made by the Federal Government are down for fiscal year 1988, as I indicated earlier, we think we can maintain the same amount of funds, outstanding financial help, for students at much lower costs to taxpayers in general. We propose to do this by moving from grants to loans, then at the same time moving to contingent loans and also taking the cap off the amount that the student may borrow.

So I would take issue with the implication of the question you just read that the administration is backing away from its commitment for education. We have, for example, some new programs in the education budget, moneys, for example, to combat adult illiteracy. I had a grandfather who was illiterate. It is not something that is completely foreign to me, personally, and it was—it is an important thing. I think various programs to stamp out adult illiteracy are something we should spend a good deal of funding on.

Chairman STENNIS. All right. I want to support this budget proposal as much and as far as I can.

I see that at best, it is a long process of getting a financially balanced budget and we can't suspend all these essential programs that we have that is tied in, particularly those that are tied in with education and training of our youth, weakening the know-how and related matters.

ECONOMIC DEVELOPMENT

I am continuing my concern here, and I may come forward with a plan that relates to matters like education and economic development. I have one question specifically on economic development.

The administration proposes to terminate or severely reduce every major Federal economic development program and shift the responsibility for economic development to State and local governments. How will rural economically depressed States, the States with the greatest need for economic development and the States which have virtually no funds for development programs and have small tax bases, how will they be able to stimulate all of the economic development needed, for the current youth without some Federal assistance?

Mr. MILLER. Mr. Chairman, I have two answers. One is, as you correctly point out, we are not eliminating that. We will have about $2.8 or $3 billion in the economic development block grant. We are proposing to end some things, urban development action grants, rental housing development grants, some of those programs that we believe have really not been directed, targeted very well. When the monies are used to build hotels and other buildings that are really going to be used by people with more substantial means, I don't think that the Federal funds are being targeted very well.

I think, in terms of stimulation of employment and the economic development in areas, rural areas, low income areas, as well as high income areas, the best thing we can do is have the economy continue to grow.

ECONOMIC EXPANSION

We are now in the 50th month of an expansion in the economy, and we are very fortunate in that. I think we will continue to have economic expansion. Most of the forecasters are indicating a great deal of confidence that the economy will continue to expand.

I think it is contingent in some part on whether we do get the deficit under control; whether we do make the progress that is called for under Gramm-Rudman-Hollings. That, I think, is the best thing that we can do for economic development, for giving poor people an opportunity to pull themselves up to get a foot on the ladder and move up that ladder.

Chairman STENNIS. All right. I am leaving the record open for any Senator to submit questions for the record.

I was reading my statement and did not quite finish the last two or three pages but was down to the subject matter of meeting deadlines. I ask consent now that my statement be included in the record as if read.

Without objection, that is agreed to.

[The statement follows:]

PREPARED STATEMENT OF HON. JOHN C. STENNIS

U.S. SENATOR FROM MISSISSIPPI

This morning the Appropriations Committee begins the first of the overview hearings on the President's proposed budget for fiscal year 1988. Today we will hear from the Honorable James C. Miller III, the Director of the Office of Management and Budget. This Friday, January 23, we will hear testimony from the Secretary of the Treasury, James A. Baker, III, on revenue estimates, the new credit reform proposals, the proposed deficit, deficit financing, the growing debt, and the international trade deficit.

Later on in February, we will have hearings with Dr. Rudolph Penner, Director of the Congressional Budget Office, at which time he will present his annual analysis of the President's Budget.

It is a privilege for me to welcome Dr. James Miller III, Director of the Office of Management and Budget, to this Committee and to these proceedings which we all view as vitally important. You have a big job, Dr. Miller, and I commend you and your assistants for the hard work required to put together such a large and comprehensive budget in a relatively short time. We look forward to hearing your statement as it relates to the President's proposed budget for Fiscal Year 1988.

While I have served as a Member of this Committee for the past thirty-two years, this is my first hearing as Chairman of this Committee. I accept this Chairmanship with a great deal of pride and also with humility, as I think of all the past great chairmen I have known from Chairman Carl Hayden to my outstanding colleague, Senator Hatfield.

This first session of the One-hundredth Congress also sees the first trillion dollar budget request ever submitted by a

President. I accept this Chairmanship with the idea of establishing goals and priorities which will help solve the problems and reduce the pressure presented by the growing public debt, which is already approaching the two trillion dollar mark.

We are at a critical period in the process of bringing the federal budget deficit under control. We are faced with some very difficult choices that must be made if we are to move ahead with the plan we have initiated to reverse the trend of increasing budget deficits. I foresee our assignment on this Committee as bipartisan.

I think you and other members of the Administration know of my personal commitment to deficit reduction. I have said, and I continue to believe, that we CAN bankrupt this nation. I do not believe we will allow that to happen, but I recognize it as a very real possibility. We absolutely must bring the deficit under control, but we must also ensure that the country continues to build its competitive edge in all areas from agriculture and rural America, to the education systems throughout out our land that lead us to technological developments and on to our military preparedness.

I have been around these halls long enough to realize that this situation cannot be turned around quickly. When President Reagan came to town six years ago promising to balance the budget within four years, I respectfully told him that I felt he was not giving himself enough time. I know he was honest about the effort, but the reality of the situation is that we are facing a monumental problem that has steadily grown. It has grown rapidly over the last six years, despite efforts by a lot of people throughout the government to bring deficits under control.

I have favored a fair and gradual approach which would bring about the desired results without inflicting special hardship on any particular segment of our population. I have honestly felt that every portion of the budget should carry part of the reductions which are necessary. After all, we have a commitment to ALL the people to keep our nation strong and viable. Nobody wants America to become second-rate in any way.

Our military superiority is certainly important, and I have always stood for a strong defense, capable of defending our interests around the globe. Defense is a basic function of government, and I have always tried to do my part in seeing that our men and women wearing the military uniform have been fully equipped and that our defenses are the best.

Military strength necessarily requires a large portion of the budget and I have generally favored the higher figures in appropriations for defense. But I am growing more and more concerned that we may not be getting the full benefit of our investment in defense, and that we may be placing too much emphasis on defense as a spending priority rather than as a preparedness priority.

I do not hold any attitude or thought that our defense should be allowed to fall behind any other nation's military. We must not allow that to happen. But I do believe we need to take a hard look at the amounts we are spending for defense and determine whether there is some room for savings. I also believe that we can make the dollars we appropriate for defense spending go further if we develop an approach which requires greater accountability.

We all know that there is a lot more to our strength as a nation than military might. The ground we have been losing in economic competition with foreign countries is sapping some of our strength, and that is a problem which must be approached with equal fervor as providing for our national defense. We must take a hard look at all of the factors that have made us strong from within, and determine what we can do to enhance those factors.

I believe that our system of education -- our desire to give everyone an opportunity to learn -- has distinguished our country from others in the world and has given us a real advantage in competition with others. Now, more than ever before, we need to strengthen our education programs to make sure that young Americans have the best possible opportunity to develop their minds to the fullest potential.

Look back at the early leaders of our nation and examine the degree of importance they placed on public education. Clearly, their emphasis paid off. Who can deny that our scientific advances and productive society has been vital to our development? Where would we be today without the schools and universities that were built and maintained by those who came before us despite the hardships and struggles they encountered?

Now, at a time when competition from foreign countries is stronger than ever, are we going to say that we have given too much emphasis to education in the past and that we should now reduce our commitment? It seems unwise to me. I will challenge this budget on that point with every bit of the strength I have.

There are other essentials involved in keeping this nation strong and competitive. This government must respond to the needs of people. We cannot turn our back on the towns and communities struggling through changing economies. Some that have been heavily dependent on agriculture and others that have relied on the oil and gas industry are suffering from a severe lack of opportunity in this, the land of opportunity. Some are hit harder than others by the harsh realities of stiffer foreign competition, such as communities where many people are employed in textile plants. We cannot turn our backs on these people in their time of need.

I am not advocating handouts here, but I am standing up for the economic development programs of our government that represent the only hope for some communities in their efforts to attract new industries to provide jobs for their people.

These are programs that help people to help themselves. The people who fill these jobs pay taxes and are productive citizens who give back to the government in so many ways.

I have said that this is a great time to be alive and in a position of leadership. The opportunities we have, working together, are unsurpassed. Our challenges are severe. We will face many difficult choices as we work toward limiting the deficit this year. Priorities must be determined and held to that will assure us of continued strength in every area.

To accomplish this, it is important for all involved to meet every deadline in this budget process so that the final result is the passage of 13 separate appropriations bills by October 1. In order to avoid the Committee's massive catchall Continuing Resolution, we need the time for each subcommittee to resolve the difficult questions which they will face in this fiscal year.

A brief word on the supplemental appropriations. You have already submitted a supplemental appropriation request for over five billion dollars for Fiscal Year 1987 and that fiscal year is barely into its second quarter. While I recognize that there are certain unforeseen emergencies that emerge at times that require additional consideration of funds, careful and thorough planning should reduce the need for supplemental appropriations. I, for one, would like to put the Administration on notice that supplemental appropriations will be only for essentials with only the highest priority.

SUPPLEMENTAL APPROPRIATIONS

Chairman STENNIS. A brief word on the supplemental appropriations is in order. You have already submitted a supplemental appropriations request for over $5 billion for fiscal year 1987, and that fiscal year is barely into its second quarter. While I recognize that there are certain unforeseen emergencies that emerge at times that require additional consideration of funds, careful and thorough planning should reduce the need for supplemental appropriations.

I, for one, would like to put the administration on notice that the supplemental appropriations will be only for essentials with only the highest priority.

Of course, these requests must be deficit neutral in both budget and authority, and outlays should stay within the budget targets.

I think it is essentially a duty upon the Appropriations Committee to see that supplemental requests are considered but that they are held in limit, the allowance of any money under that category has to actually come within that category or that definition and not let the idea of a supplemental bill be used to carry the real load of the ordinary money, the non-supplemental funds that may be desired for whatever reason.

It is another way of actually destroying the appropriations process, as followed for many decades by the legislative body that has the Senate and the House. It is destroying the whole concept to use the supplemental bills, although they are in their place; they are all right. But to use them as a substitute for carrying the major bills is something that we certainly cannot tolerate. It tends to destroy the system of appropriating, and the legislative branch of the government is giving up the tools of its trade and its operating methods.

In our view of the law, the I pledge with allegiance to try to see that something is done about this. I don't accuse anyone of having any bad purposes or anything like that.

OUT-YEAR TARGET PROPOSALS

By way of summary, the President had presented us with a budget that meets the 1988 deficit target of $108 billion. This budget, however, misses the deficit target set for 1987, 1989, and 1990 and 1991. Moreover, the balanced budget of 1991 contemplated in the Gramm-Rudman-Hollings Act is not achieved. It is postponed until the succeeding year.

We need not agree with all the details of the 1988 President's budget submission. We must keep in mind, however, that any deficit reduction proposal that we reject must be replaced by some other proposal of equal savings. If we do not, we will not achieve, in fiscal year 1988, the deficit target of $108 billion or less.

Let us take this target proposal, which has been submitted in earnest, and combine our best efforts to formulate a budget for 1988 that will direct our limited financial resources to the best use for the continued strength and vitality of our Nation and set a path for future budgets that will continue the reduction of this deficit.

This is a good place and time to begin that process, and I am sure that the members of this committee are anxious to contribute to that process. Dr. Miller, we look forward to your further contacts with our committee and hope that you will let us know anything that you want to inquire about.

We already know you will be considerate and, I judge, temporate with our additional requests as they may come in. We really enjoyed and have been benefited, too, by your presentation here this morning.

The record will be left open for the next 2 or 3 days. If any member has questions that they want to submit, we will arrange with Dr. Miller so he may to respond. That way, we save his time and it gives the membership a full opportunity to cover what they wish to cover.

Do you have anything further that you wish to say, Dr. Miller?

Mr. MILLER. Nothing, Mr. Chairman, except that I appreciate very much, again, your cordiality and working with your staff and also the staff of the minority on the committee.

I see Senator Grassley has just walked in. He might have something he wishes to ask.

Senator GRASSLEY. Am I too late, is that it?

Chairman STENNIS. No, you are not too late.

Mr. MILLER. But I do look forward to working with you.

Chairman STENNIS. All right. Senator, we have got a good surprise for you. We are going to recognize you. I didn't mean to cut you off.

Mr. MILLER. No. I look forward to working with you.

Chairman STENNIS. Thank you for your good words and your testimony, too. All right, Senator, now, I recognize you.

. NIH BUDGET PROPOSALS

Senator GRASSLEY. Mr. Chairman, I want to apologize. My entire morning has been upstairs with the Budget Committee, and Mr. Lyng, Secretary of Agriculture, was before our committee. With the importance of agriculture to my State, I thought that I ought to stay there as long as I could to ask any points.

This is a little more direct, Mr. Miller, towards a specific question than what we were able to ask you when you were before the Budget Committee a couple of weeks ago. My questions relate to the National Institutes of Health budget proposals.

Congress appropriated for fiscal year 1987 sufficient funds which would support, I have the figure here of 19,911 research projects. We gather from the budget submission that the administration plans to fund 700 fewer new and competing projects in this same fiscal year.

Will you be asking for deferral of funds which otherwise would have been spent in this fiscal year for these projects?

Mr. MILLER. We will ask for a deferral of some budget, a minor amount of budget authority of some appropriated amounts in fiscal year 1987 into 1988 so that essentially, the fiscal year 1987 and fiscal year 1988 funds would be the same. As you know, we also are proposing that budget authority be provided in fiscal year 1988, though it would not be spent in 1988. It will be spent in 1989 and so forth, and will go ahead and fund some of these projects for 2 years rather than 1 year. This would reduce uncertainty to the authors of these multiyear contracts.

So, it would be a significant increase over 1986 levels but a slight reduction from the 1987 appropriated level. Essentially, it would mean taking some funds from 1987 and putting them into 1988, a small amount of funds, and level fund the National Institutes of Health for 2 years.

Senator GRASSLEY. Isn't, then, the net effect, then, to reduce the net amount of funds by that 700 figure?

Mr. MILLER. Yes.

DEFENSE BUDGET

Senator GRASSLEY. Mr. Chairman, on one other point, and I guess it is more of a point than a question, but as in cabinet councils and as you visit, particularly with Defense, you have kept hearing the point from Secretary Weinberger, and maybe you even made it yourself, that we ought to spend more on defense because, quite frankly, we are spending less of the Gross National Product on defense now than we were in the 1960's or early 1970's.

Whether or not that is a good justification, I think, is in dispute, as well. It is still a point that is continually made as a justification for more money for defense. In regard to that, I hope when you take a look at the agricultural budget you will look at the fact that we are spending less, even now, at $26 billion for the year we are in, $26 billion for support programs, we are spending less of the Gross National Product on agricultural programs of that type than we were in the 1970's and the 1960's.

I think if you need to do that, I think there is a feeling that there is an outcry from urban areas that were spending too much. Polls now are showing that, quite frankly, urban areas are not upset with the cost of agricultural programs.

It is just a point that I would like to make. If you want to comment, okay, but I don't expect you to.

Mr. MILLER. I will do that. I do not think there is any program, though, that has grown quite as fast as price support programs, Commodity Credit Corporation programs, grew from $4 billion in 1981 to $26 billion last year. It certainly swamps the growth in the defense budget, but your point is well taken, and I will take a look at the proportion of the Gross National Product over a longer period of time.

Senator GRASSLEY. This is a point that I suppose you have been asked a lot this morning, but since I wasn't here, just simply tell me that you made a long dissertation on this, and I will look at the record, but if you didn't, then I would like an answer.

REVENUE INCREASES

Assuming that we would get to the stage of a budget summit sometime this spring between the White House and congressional leaders or Congress, generally, will the administration consider revenue increases as definitely out of the question?

Mr. MILLER. No, the administration would not consider revenue increases definitely out of the question, but we consider tax increases definitely out of the question.

Senator GRASSLEY. Okay. I understand the difference. On another point, in the past, the administration has sent up budgets that have zeroed out the Community Services Block Grant. This year, the proposal cuts only $55 billion, which is an abrupt change of policy for the administration considering that before, they wanted to eliminate it.

Did the administration have a change of heart on this program, feeling that it was maybe serving better purposes than they thought when they wanted to zero it out, or is it kind of a case of understanding the facts of life that Congress has always kept a program alive?

Mr. MILLER. The latter.

Senator GRASSLEY. Again, assuming that we would have a summit, will the administration consider out of the question an increase in the budget targets under Gramm-Rudman formula? That is that $108 billion deficit target we have to meet for 1988.

Mr. MILLER. Out of the question.

Senator GRASSLEY. Okay. Mr. Chairman, I have no further questions.

Chairman STENNIS. Thank you very much for coming over. I am glad we were still here. Did you handle all the questions you wanted?

Senator GRASSLEY. Yes. Thank you, Mr. Chairman. Thank you, Mr. Miller.

Chairman STENNIS. Do you have something more Mr. Miller? You can make any statement you wish.

Mr. MILLER. No, no, sir. I thank you again for the opportunity to appear before you.

Chairman STENNIS. I thank you. Thank you for being here. You have been helpful to all of us. I do want to call your attention to one question that I can just file here and you can have it checked on and give us the answer later.

What is the total amount of your request to this committee to appropriate in this fiscal year 1988? Our list compares with 1987. You can give your attention to this at some later time.

SUBMITTED QUESTIONS

The submitted questions by committee members alluded to earlier in the hearing will be inserted in the record at this point.

[The following questions were not asked at the hearing, but were submitted to OMB for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR STENNIS

HEALTH CARE

QUESTION:

Many of our rural communities have difficulty getting physicians to come and practice in their areas. The only Federal Program that specifically addresses this problem is the National Health Service Corps Scholarship Program. The President's Budget requests no new scholarship money for this program.

By eliminating the Scholarship program that provides our rural areas with doctors, does the Administration believe that our rural communities do not have a problem in attracting medical professionals?

ANSWER:

Since 1972, when the National Health Service Corps began placing physicians, the number of health manpower shortage areas (HMSAs) has decreased, while the number of physicians has increased. From 1980 to 1985, the number of physicians needed in primary care shortage areas decreased by 25 percent. Over the same period, the number of physicians per capita increased by 22 percent. A June 1983 study of HMSAs projected that diffusion of primary care physicians would reduce the number of shortage areas by 50 percent between 1982 and 1992. The natural diffusion of physicians is making it easier for rural communities to attract medical professionals.

In addition to the abundance of physicians in metropolitan areas, recent changes of the health care industry have contributed to expanded availability of health care in rural areas. Through increased competition, the health care industry is making more efficient use of physicians, which further reduces their demand in the well-served metropolitan areas. As a result, health care providers in the form of health maintenance organizations and health care consortia are expanding their operations into rural areas at an increased rate.

In addition to Federal efforts to place health professionals in shortage areas, there are 35 State programs to help place health professionals. Over 2,000 health professionals (primarily physicians) have participated in State programs over the past several years.

REQUESTED APPROPRIATED AMOUNTS

QUESTION:

What is the total amount you are requesting this Committee to appropriate in FY 1988? How does that compare with the 1987 enacted level?

ANSWER:

Total Appropriations
(in billions of dollars)

	Enact FY 87	Reqst FY 88	Diff.
Budget Authority.......	564	561	-3

NOTE: Does not include loan and obligation limitations.

QUESTION:

What is the total amount of domestic discretionary spending you are requesting this Committee to appropriate in FY 1988? How does that compare with the 1987 and 1981 enacted levels?

ANSWER:

Domestic Discretionary Spending
(in billions of dollars)

	Enact FY 81	Enact FY 87	Reqst FY 88	Diff. Reqst/81	Diff. Reqst/87
Budget Authority....	113	125	122	9	-3

QUESTION:

Are you fully satisfied that your budget is adequate and sufficient to meet our domestic and national security needs?

ANSWER:

The Administration's 1988 budget request is consistent with the programs presented in the budget and is sufficient to fund the proposals outlined in the President's Quest for Excellence, set forth in his State of the Union Address.

America's competitive preeminence in the world economy is critical to our standard of living and national security. The Administration is launching a six-part program that will mobilize Federal government resources to help us maintain our preeminence well into the 21st century. The program will include:

1. Increasing investment in human capital.
2. Promoting the development of science and technology.
3. Protecting intellectual property.
4. Enacting legal and regulatory reform.
5. Shaping the international economic environment.
6. Reforming the federal budget process.

As we expand economic opportunity, we must also work to sustain our traditional cultural and moral values. The Administration proposes several initiatives designed to support our belief in the dignity of self-supporting individuals and families and in safe and self-governing communities. These include catastropic illness coverage and drug abuse prevention.

In the past six years, the Administration has pursued a foreign policy based on realism--about the nature of our adversaries, the need to rebuild our military strength, and the opportunities to expand democracy and economic freedom around the world. We have also operated with the belief that a strong bipartisan consensus in Congress is essential for a successful foreign policy, and toward that end the President will present in the near future a comprehensive report on American foreign policy. Some specific areas of concern include: building on East-West relations and maintaining a strong national defense.

The Administration's goal is to lay the groundwork for continued excellence into the 21st century. These initiatives will lead us toward that goal.

FEDERAL CIVILIAN EMPLOYMENT

QUESTION:

Mr. Miller, The President has made it clear that he wants to reduce the size and scope of our Federal Government. I believe that one measure of the size and scope of Government is the number of employees. The

President's Fiscal Year 1988 Budget proposal estimates that there will be 2,120,135 Federal civilian employees. This is 44,372 or 2.1 percent above the number of Federal civilian employees in Fiscal Year 1982. Do you believe the President can reduce the size and scope of Government while increasing the number of its employees?

ANSWER:

Yes. In fact, the President's original goal of reducing non-defense employment by 75,000 workyears was achieved by the end of fiscal year 1984. The following table illustrates the trends in Federal civilian employment (in terms of workyears or full-time equivalents (FTE's)) from fiscal year 1982 through fiscal year 1988.

Full-Time Equivalent Civilian Employment
Executive Branch

	Defense	Non-Defense	Total
FY 1982	978,081	1,097,682	2,075,763
FY 1983	984,806	1,092,034	2,076,840
FY 1984	1,011,532	1,084,996	2,096,528
FY 1985	1,036,870	1,085,105	2,121,975
FY 1986	1,041,352	1,072,789	2,114,141
FY 1987(est.)	1,039,000	1,075,017	2,114,017
FY 1988(est.)	1,037,000	1,083,135	2,120,135

As indicated, there has been a nearly steady decrese in non-defense civilian employment, yet, at the same time, necessary increases for tax reform, new immigration law requirements, and law enforcement activities in general have been made -- consistent with Administration priorities.

Over the same period, civilian employment in the Department of Defense has increased, consistent with the Administration's goal of strengthening the country's national defense posture.

Overall, the Administration will continue its commitment to reduce the size of the Federal workforce while maintaining the minimum necessary to function efficiently.

QUESTION:

A large part of the President's proposed FY 1987 supplemental is for the initial cost of the newly-enacted Federal Employee Retirement System or FERS. It is clear from the President's proposal that not all agencies received supplemental funding to offset the increased cost of the new FERS program. Could you tell the committee what the total cost of the new system will be and what percentage of this cost you are asking each agency to absorb?

ANSWER:

OMB did not keep a central tally of all agency requests for increased retirement costs due to the Federal Employees' Retirement System (FERS). During the mid-session review of last summer, we had estimated $1.4 billion would be necessary in 1987 for increased contributions to the Civil Service Retirement and Disability Fund and the Thrift Savings Fund due to FERS. These estimates were reflected in the mid-session review estimates.

We have just completed collecting updated information on increased retirement costs in 1987 for FERS. The resulting information is attached in an answer to a previous question.

FISCAL YEAR 1987 AGENCY CONTRIBUTION FOR THE
FEDERAL EMPLOYEE RETIREMENT SYSTEM (FERS)
(in millions of dollars)*

Agency of Government	Increased Cost	Net Absorbtion			Additional Appropriations Requested
		Administrative Action	Congressional Action	Total	
Agency for International Development.......	5.7	---	---	---	5.7
Department of Agriculture.......	60.4	24.4	36.0	60.4	---
Department of Commerce..........	16.4	0.8	0.4	1.2	15.1
Department of Defense-Military..	565.0	---	---	---	565.0
Department of Defense-Civil..... Corps of Engineers.	14.9	13.5	1.4	14.9	---
Department of Education.........	3.0	3.0	---	3.0	---
Department of Energy............	11.3	11.3	---	11.3	
Department of Health and Human Services (except Social Security)..	33.9	20.4	13.4	33.9	---
Social Security....	36.5	36.5	---	36.5	---

FISCAL YEAR 1987 AGENCY CONTRIBUTION FOR THE FEDERAL EMPLOYEE RETIREMENT SYSTEM (FERS) (in millions of dollars)*

(continued)

Agency of Government	Increased Cost	Net Absorbtion			Additional Appropriations Requested
		Administrative Action	Congressional Action	Total	
Department of Housing and Urban Development.	9.8	9.8	---	9.8	---
Department of the Interior......	34.0	33.3	0.7	34.0	---
Department of Justice...........	70.4	1.7	---	1.7	68.7
Department of Labor.............	12.4	5.7	6.1	11.9	0.5
Department of State.............	17.2	0.5	---	0.5	16.7
Department of Transportation....	54.0	---	54.0	54.0	---
Department of the Treasury..........	146.3	24.3	---	24.3	122.0
Environmental Protection Agency.	13.0	3.0	10.0	13.0	---
General Services Administration....	3.8	3.8	---	3.8	---

FISCAL YEAR 1987 AGENCY CONTRIBUTION FOR THE FEDERAL EMPLOYEE RETIREMENT SYSTEM (FERS)
(in millions of dollars)*

(continued)

Agency of Government	Increased Cost	Net Absorbtion			Additional Appropriations Requested
		Administrative Action	Congressional Action	Total	
National Aeronautics and Space Administration...........	16.6	---	16.6	16.6	---
Office of Personnel Management........	2.6	2.6	---	2.6	---
Small Business Administration....	2.4	---	2.4	2.4	---
Veterans Administration....	142.2	---	---	---	142.2
Federal Deposit Insurance Corporation.......	4.8	4.8	---	4.8	---
United States Information Agency............	6.0	---	---	---	6.0
Total (major executive branch agencies).........	1,282.6	199.4	141.0	340.6	941.9
Percent absorbtion.	26.5				

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*/ Totals may not add due to rounding.
Note: Excludes Legislative Branch, the Judiciary, and small executive agencies.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 24, 1986

BULLETIN NO. 87-2

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Agency Contributions for Employee Retirement under the Federal Employee Retirement System

1. Purpose. This Bulletin provides policies and procedures for:

-- reflecting increases in the employer share of retirement costs due to enactment of the new Federal Employees' Retirement System (FERS) in agency budget estimates; and

-- requesting supplementals for these increases in fiscal year (FY) 1987.

2. Authority. The Federal Employees' Retirement System Act of 1986, P.L. 99-335, establishes a retirement program for Federal civilian employees and postal workers hired after December 31, 1983 who are covered by social security, and for employees under the Civil Service Retirement System (CSRS) who choose to transfer into the new system. This act sets an effective date of January 1, 1987 to begin coverage of post-1983 hires under FERS.

The Omnibus Budget Reconciliation Act of 1986 revises the effective date for participation of post-1983 hires in the thrift plan from January 1, 1987 to the first pay period in April. The effective date for this group for the basic annuity and social security components of FERS was not changed by this law. FERS provisions related to employees transferring from CSRS also were not changed by this law.

3. Background Prior to enactment of P.L. 99-335, employing agencies made payments matching employees' retirement contributions (7 percent of the basic pay for employees, and 7.5 percent for Congressional employees, law enforcement officers, and firefighters) to the civil service retirement and disability fund. Since these employee and agency contributions fall far short of financing accruing costs of CSRS benefits, an annual payment is made to the fund by the Treasury ($16.3 billion in FY 1986) to finance a part of the unfunded liability.

Unlike CSRS, the new FERS will be fully financed by agency and employee contributions beginning January 1, 1987.

The information submitted pursuant to this Bulletin will provide the basis both for revising agency budget estimates and for requesting any FY 1987 retirement supplementals that may be included in the President's FY 1988 Budget.

4. Coverage. These instructions apply to all Executive Branch agencies, including the U.S. Postal Service. The District of Columbia is not covered by these requirements.

5. Due Dates. Agencies will calculate the increased retirement costs related to FERS, revise agency budget requests accordingly, and submit the required materials as described in section 9 by Friday, November 7, 1986, to the OMB representative responsible for reviewing the agency's budget estimates. The assumptions to be used in the calculations are provided in section 6 and Attachment A; an illustration of the way the increased costs should be calculated is found at Attachment B. Attachment C provides instructions on preparing the required submissions to OMB.

6. Policies.

a) Agencies will revise their FY 1988 budget submissions to incorporate estimates of increased retirement costs. Revisions should be made to materials included in the initial budget submission pertaining to various funding options, as well as to the agency request.

b) Because agency costs will vary depending on the extent of participation in FERS and in the thrift plan by various types of employees, agencies will be required to estimate retirement costs for several segments of the workforce separately. For estimating purposes, agencies will determine the aggregate payroll attributable to 3 populations: post-1983 hires (employees hired after December 31, 1983), "switchers" (CSRS enrollees switching into FERS), and "CSRS enrollees" (employees opting to stay in the current CSRS plan). (Agencies with law enforcement or other special category personnel will also need to calculate the increased costs separately for each category).

c) All agencies will utilize the same assumptions with respect to participation in FERS, thrift plan utilization, timing of enrollment, growth of FERS (as a proportion of total payroll), and contribution rates. (The assumptions are provided in Attachment A.) An agency may use alternative assumptions for proportions of payroll attributable to FERS (see table 1 of Attachment A) only if it can provide convincing justification for doing so.

7. FY 1987 Supplementals. Each agency will include in its budget submission an estimate, based on the partial implementation of FERS in FY 1987, of the supplemental likely to be requested to finance FY 1987 retirement increases. Estimates of FY 1987 supplemental requests for retirement will not include the effects of increased costs due to a FY 1987 pay raise. Separate instructions on pay raise costs will be issued later and will provide guidance on calculating the effect of the pay raise on agency retirement contributions.

8. Absorption of Increased Retirement Costs.

a) Generally, agencies are expected to absorb the maximum amount possible of the increased retirement costs in FY 1987 and beyond. Agencies will be required to submit specific justification for any amount of retirement costs that cannot be absorbed.

9. Action Requirements.

a) Each agency should make sure that the new retirement rates are reflected in their budget estimates for FY 1987, FY 1988 and for FY 1989-1992.

b) Each agency will submit to OMB the following materials for the purpose of determining the need for FY 1987 supplementals and higher budget requests for FY 1988:

1) Summary of Revised Budget Submission and Supporting Detail. The summary will be prepared in accordance with the instructions in Attachment C and in the format of the exhibit. The summary will include information both on the initial budget submission and the FY 1987 and FY 1988 request revised to reflect the effect of increased retirement costs. Supporting information will include account level detail supporting the summary and any other materials submitted with the initial agency request.

2) Information Sheets. Information sheets showing the methods and numbers used to make the calculations that determine the increased retirement costs will accompany the summary discussed above and must be prepared in accordance with section 6 of this Bulletin and Attachments A and B.

3) Narrative Explanation. Increases in retirement costs that are disproportionately high in relation to the base for any account (e.g., due to large numbers of special class employees) or the use of proportions exceeding those specified in table 1 of Attachment A must be fully justified in a narrative explanation accompanying the summary.

10. OMB Responsibilities. The Office of Management and Budget will review the information submitted as part of the FY 1988 budget process.

11. Information Contact. For further information, contact the OMB representative responsible for reviewing the agency's budget estimates.

12. Sunset Date. This Bulletin will expire as soon as action is completed.

James C. Miller III
Director

Attachments

Attachment A
OMB Bulletin No. 87-2

Assumptions for Calculation of Increased Retirement Costs

A. General assumptions.

(1) Participation - It is assumed that 40 percent of CSRS enrollees will switch into the new FERS between July 1, 1987 and January 1, 1988. (This assumption is incorporated in the percentages shown in table 1 of this Attachment.)

(2) Thrift plan utilization - Under the plan, agencies will contribute 1 percent of payroll for every FERS enrollee even if the employee contributes nothing. In addition, agencies must match 100 percent of employee's first 3 percent of pay contributed to the plan and 50 percent of the next 2 percent. Agency contributions to the Federal Retirement Thrift Investment Board for the thrift plan will be assumed to be static, in percentage terms, over the 5-year estimating period.

Agencies are to use the following actuarial projections regarding employee contributions to the thrift plan for FY 1987-1992. Specifically, they are to utilize a 3 percent total contribution on behalf of post-1983 hires, and a 4 percent total contribution on behalf of the population switching into FERS. (These rates include the 1 percent contribution required for every FERS enrollee and incorporate the impact on post-1983 hires' contributions of changes in employer matching contributions, maximum contributions, and effective dates included in the Omnibus Budget Reconciliation Act of 1986.)

(3) Timing of enrollment - Under FERS, agency contributions to social security (i.e., to the Federal old-age and survivors and disability insurance trust funds, known as OASDI), and the civil service retirement fund will begin January 1, 1987 for post-1983 hires. Contributions to the Thrift Investment Board for the thrift plan will begin the first pay period in April, 1987 for these employees. For estimating purposes, it is assumed that half of the current CSRS enrollees who will switch will do so July 1, 1987. The remaining half will do so December 31, 1987.

(4) FERS-covered population - The amount of agency contributions will be determined by applying the percentages spelled out in sections C through H of this attachment to the payroll attributable to the 3 populations identified as post-1983 hires, switchers, and CSRS enrollees. These populations may vary by agency but should not be substantially different from the following Government-wide averages.

Table 1. Government-wide Participation in FERS/CSRS
(Percentage Of Total Payroll)

	Fiscal Year					
	1987*	1988*	1989	1990	1991	1992
Post-1983 hires...............	12	20	23	26	29	32
Switchers.....................	4	28	31	30	28	26
Total FERS Population........	16	48	54	56	57	58
CSRS Enrollees................	84	52	46	44	43	42
Total Retirement.............	100	100	100	100	100	100

* Adjusted to reflect timing of enrollment, as discussed above.

Agencies should use the above proportions of total payroll for purposes of cost estimates unless they can demonstrate convincingly to their OMB representative that other proportions are more appropriate.

Under FERS, agency contributions will be made to the civil service retirement and disability fund for the basic annuity, to the OASDI for social security, and to the Thrift Investment Board for the optional thrift plan.

B. FICA wage base.

The wage base on which agencies are to compute OASDI (FICA) costs is expected to increase from $42,000 in calendar year 1986, as indicated in Table 2. The wage base is adjusted, for purposes of budget estimates, to a fiscal year basis in the following table.

Table 2. FICA Wage Base
(Amounts in dollars)

	1987	1988	1989	1990	1991	1992
Calendar year..........	43,800	45,600	48,600	51,300	54,300	57,000
Fiscal year............	43,350	45,150	47,850	50,630	53,550	56,330

C. OASDI tax.

The OASDI tax rate applied against covered payroll (total payroll up to the FICA wage base) will increase from the 5.7 percent rate in 1986 according to the schedule shown in Table 3. In row 2, the tax rate is adjusted to a fiscal year basis for the purpose of budget estimates.

Table 3. OASDI Tax Rate
(Percentage of Covered Payroll)

	1987	1988	1989	1990	1991	1992
Calendar year..........	5.7	6.06	6.06	6.2	6.2	6.2
Fiscal year............	5.7	5.97	6.06	6.17	6.2	6.2

D. Calculation of retirement costs for post-1983 hires enrolled under FERS as of January 1, 1987.

All agency estimates submitted to OMB for the FY 1988 Budget will be revised to reflect the following agency contributions to OASDI, the civil service retirement and disability fund, and the Thrift Investment Board for the thrift plan. (Employee contributions are also listed for informational purposes and to provide total FERS cost figures).

Table 4. Post-1983 Hires Population
(Percentage of Payroll)

	Fiscal Year					
	1987	1988	1989	1990	1991	1992
Employer Contribution to:						
OASDI..................	5.70	5.97	6.06	6.17	6.20	6.20
CSRS/FERS..............	14.70	14.97	15.06	15.17	15.20	15.20
Thrift plan............	3.00	3.00	3.00	3.00	3.00	3.00
Total..............	23.40	23.94	24.12	24.34	24.40	24.40
Employee Contribution to:						
OASDI..................	5.70	5.97	6.06	6.17	6.20	6.20
CSRS/FERS..............	1.30	1.03	.94	.83	.80	.80
Thrift plan............	2.00	2.00	2.00	2.00	2.00	2.00
Total..............	9.00	9.00	9.00	9.00	9.00	9.00
Total Retirement*..	32.40	32.94	33.12	33.34	33.40	33.40

* These factors do not include the Health Insurance (HI) tax already in effect which costs agencies and employees an additional 1.45 percent of pay subject to FICA each year.

E. Calculation of retirement costs for current CSRS enrollees switching into FERS July 1-December 31, 1987.

For "switchers," agency estimates submitted to OMB will apply the same percentages shown above to the FERS aggregate payroll estimate, except with respect to the thrift plan payment. Instead of a 3 percent contribution, agencies will assume a 4 percent contribution. In general, these employees are paid more than post-1983 hires and will probably elect to defer an estimated 3 percent of their salaries to the FERS thrift plan instead of 2 percent. Total agency and employee payments will thus be as follows:

Table 5. Population Switching from CSRS to FERS
(Percentage of Payroll)

	Fiscal Year					
	1987	1988	1989	1990	1991	1992
Total Employer Contribution...	24.40	24.94	25.12	25.34	25.40	25.40
Total Employee Contribution...	10.00	10.00	10.00	10.00	10.00	10.00
Total Retirement*..............	34.40	34.94	35.12	35.34	35.40	35.40

* No HI tax included.

F. Calculation of retirement costs for employees who remain under CSRS.

Agency and employee contributions to pay for CSRS coverage have not been changed by either the new FERS law or the Reconciliation Act of 1986 and should be budgeted for as in the past, per paragraph 3 of the bulletin.

G. Calculation of retirement costs for special class employees -- law enforcement, air traffic controllers, foreign service, etc., with post-1983 status beginning January 1, 1987.

Because special class benefits under FERS must also be fully financed by agency and employee, and because these benefits are considerably more expensive than normal retirement benefits, agencies must separate these categories of employees and separately budget for these additional costs utilizing the following factors:

Table 6. Post-1983 Hires-Special Class Population
(Percentage of Payroll)

	Fiscal Year					
	1987	1988	1989	1990	1991	1992
Employer Contribution to:						
OASDI........................	5.70	5.97	6.06	6.17	6.20	6.20
CSRS/FERS*...................	30.00	30.27	30.36	30.47	30.50	30.50
Thrift plan..................	3.00	3.00	3.00	3.00	3.00	3.00
Total...............	38.70	39.24	39.42	39.64	39.70	39.70
Employee Contribution to:						
OASDI........................	5.70	5.97	6.06	6.17	6.20	6.20
CSRS/FERS*...................	1.80	1.53	1.44	1.33	1.30	1.30
Thrift plan..................	2.00	2.00	2.00	2.00	2.00	2.00
Total...............	9.50	9.50	9.50	9.50	9.50	9.50
Total Retirement**..	48.20	48.74	48.92	49.14	49.20	49.20

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* Applies also to payments made to the Foreign Service retirement and disability fund for foreign service officers and employees.

** Does not include HI tax.

H. Calculation of retirement costs for special class employees who switch into FERS July 1-December 31, 1987.

As was the case for those employees switching into FERS (discussed in section E of this attachment), special class employees who switch will have worked longer, are likely to be higher paid, and thus will defer more of their salaries into the FERS thrift plan. Agency contributions for these employees are the same as those listed above except with respect to the thrift plan contribution which will be 4 percent (instead of 3 percent) to match an employee payment of 3 percent (instead of 2 percent) each year. Totals are as follows:

Table 7. Special Class Population Switching Into FERS
(Percentage of Payroll)

	Fiscal Year					
	1987	1988	1989	1990	1991	1992
Total employer contribution..........	39.70	40.24	40.42	40.64	40.70	40.70
Total employee contribution..........	10.50	10.50	10.50	10.50	10.50	10.50
Total Retirement*......	50.20	50.74	50.92	51.14	51.20	51.20

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* Does not include HI tax.

Attachment B
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Illustration of Steps Necessary to Calculate Increased Retirement Costs

In this example, the agency has a staff of 18: eight GS-9, eight GS-13, and two SES FTEs. The calculations are shown for 1987 only. Agencies will, however, be required to make similar calculations for fiscal years 1987-1992.

Step 1 - **Calculate the aggregate payroll.** Multiply the estimated payroll for each group of FTEs by the number of FTEs at each grade level.

Example:

8 GS-9 = 21,804 x 8 = 174,432
8 GS-13 = 37,599 x 8 = 300,792
2 SES = 69,468 x 2 = 138,936

Aggregate payroll = 614,160

Step 2 - **Calculate the retirement populations** for the 3 categories of employees (post-1983 hires, switchers and CSRS enrollees) separately. To determine the population for each category, multiply the aggregate payroll by the percentages shown in table 1 of Attachment A for each fiscal year. Calculate the total FERS payroll (the sum of post-1983 hires and switchers) for use in step 3.

Example:

Post-1983 hires	.12 x 614,160 =	73,699.20
Switchers	.04 x 614,160 =	24,566.40
Total FERS		98,265.60
CSRS enrollees	.84 x 614,160 =	515,894.40
		614,160.00

Step 3 - **Calculate payroll subject to OASDI Tax**

First, calculate the total amount of payroll not subject to OASDI tax. Specifically, determine the amount of payroll in excess of the FICA wage base (shown in Table 2 of Attachment A) for each FTE, multiply that amount by the number of FTEs at that salary level and add the amounts for each salary level.

For this calculation, the proportion of FERS payroll not subject to OASDI tax will be assumed to be the same as the proportion of total payroll not subject to the OASDI tax.

Multiply the FERS payroll by this amount and subtract the result from the amount of FERS payroll. The resulting amount is the payroll subject to OASDI tax.

Example:

Amount not subject to OASDI tax = (69,468 - 43,350) x 2 = 52,236

Proportion attributable to FERS payroll = $\frac{52,236}{614,160}$ = .09

FERS payroll x .09 = 98,265.60 x .09 = 8,843.90

FERS payroll subject to OASDI tax = 98,265.60 - 8,843.90

= 89,421.70

Step 4 - Calculate agency contributions

To determine agency contributions, multiply the payroll attributable to each population by the applicable percentages for each year. (See Attachment A, sections C through F and tables 3 through 5.) Note that for FERS enrollees, the percentage of payroll for agency contributions for OASDI and CSRS/FERS is the same for post-1983 hires and switchers; contributions for the thrift plan, however, are different. Agency contributions for CSRS enrollees have not been changed by law. Add the sum of each type of agency contribution to determine the total retirement contribution for the agency.

Example:

Agency 1987 contributions:

To: OASDI		
For FERS enrollees.........	89,421.70 x .057	= 5,097.04
To: CSRS/FERS		
For FERS enrollees.........	98,265.60 x .147	= 14,445.04
For CSRS enrollees.........	515,894.40 x .07	= 36,112.61
Subtotal, CSRS/FERS.....		50,557.65
To: Thrift plan for FERS enrollees		
For Post-1983..............	73,699.20 x .03 =	2,210.98
For Switchers..............	24,566.40 x .04 =	982.66
Subtotal, thrift plan...		3,193.64
Total agency contributions.............		58,848.33

Step 5 - Calculate agency contributions for special class employees

Follow step 4 calculations, using the percentages that are shown in sections G and H and tables 6 and 7 of Attachment A.

Step 6 - Calculate the total increase in agency contributions

Subtract the total agency contributions budgeted for the fiscal year from the total agency contributions calculated using the assumptions in the bulletin (i.e., with some employees covered by FERS and others by CSRS). The remainder will be the increased costs due to the new retirement system.

Example:

Agency contributions budgeted for 1987:

Post-1983 hires	73,699.20 x .127*	= 9,359.80
All others	540,460.80 x .07	= 37,832.26
Total		47,192.06
Increase in agency contributions due to new retirement system =	58,848.33	- 47,192.06 = 11,656.27

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* Under interim coverage in place before new law was enacted, agency contributions for post-1983 hires consisted of payments to OASDI (5.7 percent) and to CSRS (7 percent).

Attachment C
OMB Bulletin No. 87-2

Instructions for Preparing the Summary of Revised Budget Submissions

Each agency will submit an original and one copy of the required report in the format of the exhibit. Related materials supporting this summary are also required, as described below. Agencies are required to provide summary information on both the initial budget requests and the revised FY 1987 and FY 1988 requests that reflect the effect of increased retirement costs due to changes in agency contributions under the new Federal Employees' Retirement System. The reports are due no later than November 7, 1986.

Columns 1, 2 and 6. Report total budget authority and outlays for the agency for FY 1986, 1987 and 1988, respectively, as included in the initial budget submission due September 1, 1986.

Column 3. Report the revised estimate of total budget authority and outlays for the agency for FY 1987 that reflects increased agency contributions for retirement.

Column 4. Include the amount of absorption of FY 1987 increased retirement costs that is reflected in revised request for that year reported in column 3. Also, provide specific justification for any amount of increased retirement costs for FY 1987 that cannot be absorbed.

Column 5. Report the amount of the additional appropriation required as a result of increased retirement costs. This amount should not represent the total increased costs due to the new retirement system, unless no absorption is possible. This amount should not include the effects of increased costs due to a FY 1987 pay raise.

Column 7. Report the total budget authority and outlays for FY 1988 that reflects increased agency contributions for retirement. Indicate in a footnote the amount of any FY 1988 increased retirement costs that were absorbed.

Related materials. The required summary report is intended to provide a quick overview of the revised budget submissions. Supporting information accompanying the summary should include: (a) revised totals reflecting retirement increases for the outyears (1989-1992); (b) account level detail supporting the revised agency totals reported in the summary; and (c) other materials included in the initial submission (e.g., materials pertaining to various funding/FTE options, as well as to the agency request) revised to reflect the increased retirement costs. In addition, agencies will provide information sheets showing the calculations used to determine the increased retirement costs and a narrative explanation for increases that are disproportionately high in relation to the base for any account. (See section 9 of the Bulletin.)

Summary of Revised Budget Submission
Department of Government
(in thousands of dollars)

		FY 1987				FY 1988	
	FY 1986 (1)	Initial Request (2)	Revised Request (3)	Amount of Absorption (4)	Supplemental for retirement 1/ (5)	Initial Request (6)	Revised Request 1/ (7)
Budget authority....							
Outlays.............							

1/ Provide specific justification for any amount of increased retirement costs that cannot be absorbed.

/See Attachment C for a list of required materials to be submitted with this summary./

QUESTIONS SUBMITTED BY SENATOR CHILES

OLDER AMERICANS ACT

QUESTION:

You have proposed a standstill budget for Older Americans Act programs. Wouldn't it be better to invest more in these programs, (adult day care, home maker aides, respite care), in order to avoid or postpone the more expensive alternatives such as nursing home care?

ANSWER:

We have not at all proposed a standstill budget for Older Americans Act programs. The Budget accepts the FY87 enacted levels for the Title III supportive services, congregate meals, and home-delivered meals programs. These levels are significant increases over the FY86 levels.

For FY88, funding for the Older Americans Act programs is included in the $2.2 billion generic appropriation request for social service activities administered by the HHS Office of the Human Development Services. Congress is invited to define priorities selectively within the $2.2 billion requested level of effort. Older Americans Act programs will retain their separate statutory authorization, but under a generic appropriation, HHS would have the discretion to use its program expertise in determining funding levels for specific programs and initiatives. The Title III supportive services and nutrition services programs for older Americans would be one of the Administration's highest social service priorities.

In addition, the Administration will be proposing legislation to reauthorize the Older Americans Act programs and target funds to the most vulnerable elderly (such as low-income older persons and the very old). We believe the combination of flexibilty for HHS program experts under a generic social services appropriation and targetting Older Americans Act funds to the elderly persons most in need of services will best serve the nation's elderly population.

NATIONAL INSTITUTES OF HEALTH

QUESTION:

You are proposing to "stretch out" fiscal 1987 appropriations for the National Institutes of Health, using hundreds of millions of dollars to offset the need for fiscal 1988 appropriations.

* How much would your fiscal 1988 budget request for NIH have to be increased if you fully carried out the intent of Congress in spending fiscal 1987 appropriations in fiscal 1987?

* Why haven't you submitted a deferral message, if you are not spending $334 million in fiscal 1987 NIH appropriations?

Follow-Up:

Can you assure us that NIH will keep your committment not to cut back levels or numbers of grants until Congress has acted on your bill language to defer spending of funds?

ANSWER:

The President has requested that Congress permit the National Institutes of Health (NIH) to obligate $334 million, or about 5.5 percent of its fiscal year 1987 appropriation, in fiscal year 1988. This proposal is part of the President's longterm policy of providing stable and sustainable support for NIH.

NIH has the administrative discretion to determine how best to manage spending during the fiscal year based on the programmatic goals of NIH. Under the current NIH spending plan, research project grants are being awarded in a manner that will place NIH in a position to implement both the intent of Congress with respect to the NIH appropriation and the President's revised budget policy should Congress agree to the Administration's proposal. NIH will not take any action that would inhibit its ability to obligate fully all funds appropriated for fiscal year 1987 in a programmatically effective manner.

All noncompeting continuation grants continue to be awarded as they come due in accordance with the normal grant cycle. On average, the current amount awarded for each project represents a 3 percent increase over fiscal year 1986 rather than the 11 percent that would be possible under the appropriation. Depending on the congressional response to the President's proposal, future increases are possible. New and competing grants are being awarded at a rate that would permit NIH to comply with either the proposed 5,654 level or the 6,354 number possible under the appropriation. On average, new and competing awards reflect an average 10 percent increase over fiscal year 1986 rather than the 17 percent possible under the appropriation. Again, depending on the congressional response to the President's proposal, future increases are possible.

These programmatic adjustments are consistent with earlier uses of NIH's administrative discretion to manage its spending plans during the course of a fiscal year.

The President's proposal would take effect only when the Congress approves the supplemental appropriations language submitted to the Congress on January 5th. Should Congress not accept the President's proposal for extended availability, NIH could make supplemental awards to grantees.

Social Security Staff

QUESTION:

We understand you intend to reduce staffing for the Social Security Administration to 73,270 full-time equivalent (FTE) positions in fiscal 1987, even though Congress intended a level of 74,437 FTE's. When the Executive Branch fails to follow the intent of Congress on staffing levels, why shouldn't we include statutory language in appropriations bills? What will be the impact of your proposal to cut another 5,000 staff in fiscal 1988, down to 69,345 FTE?

ANSWER:

Our objective is to maintain high quality service to the public while being efficient and conserving trust funds dollars. SSA expects continued productivity improvements from the nearly $1 billion invested in automation. Previously manual tasks have been automated, improving the accuracy and efficiency of service. SSA and the GAO will monitor service to the public to ensure service stays high. If there is evidence that service is deteriorating, we will quickly reevaluate staffing requirements.

CATASTROPHIC HEALTH COVERAGE - MEDICARE

QUESTION:

Recently, Secretary Bowen proposed a catastrophic insurance plan for Medicare beneficiaries. For an additional premium of $4.92 a month (above the existing $17.90 a month premium), Medicare beneficiaries would be guaranteed that out of pocket expenses for Medicare covered services would not exceed $2,000 a year, even if 365 days of hospital care are required.

- Does the Administration intend to formally propose this plan to the Congress in the near future?
- If not, why not?
- Secretary Bowen's proposed plan does not include coverage for nursing home care, a service not currently covered by Medicare. These costs constitute a major source of catastrophic expense for the elderly. Does the Administration have any proposals to address this type of catastrophic health coverage for the elderly?

ANSWER:

The President announced the Administration will submit legislation implementating the Medicare coverage plan developed by Secretary Bowen in his Report to the President.

Regarding long-term care for older Americans, there are no easy answers. But in its second major initiative, our proposal calls for studies by the Treasury Department and others to find ways of meeting these costs. Of course, it's too early to predict what solutions will be found, but the important point is that our proposals calls on the Government to start looking.

Vocational Education and Job Training

QUESTION:

Your budget proposes zeroing out $875 million in Federal funding for vocational education, at the same time that you recommend legislation to expand job training programs by a $1 billion. It doesn't sound like these two proposals were well coordinated.

- o What is the rationale for eliminating vocational education programs while you are expanding job training?
- o Was this a decision made at OMB, or does it reflect differing priorities within the Departments of Education and Labor? When will you transmit legislation for the new job training programs?

(Background: The extra $1 billion for fiscal 1988 Labor Department programs is proposed for later transmittal with new legislation, the elimination of vocational education programs is proposed to begin in fiscal 1987, with a rescission of $432 million.)

ANSWER:

The decisions on vocational education and on job training are not inconsistent.

Federal funds for vocational education supply less than one dollar of every eleven spent. The States and localities provide the remainder. Federal funds are not only a small share of the total, they are provided in an extraordinarily complex and heavily prescribed manner that is impossible to justify. Vocational education at the postsecondary level is also financed by Federal student aid funds. The Federal vocational education grants therefore duplicate student aid. Moreover, they do so in ways that are inefficient because they fund institutions, thus not allowing the student the freedom of choice that Federal grants and loans do. Vocational education at the secondary level provides only small and transitory benefits to participants. Clearly, there are more pressing needs for these funds than are satisfied by Federal grants to vocational education.

On the other hand, Job Training and Partnership Act funds go for particular training needs of economically disadvantaged youth and adults established in accord with the priorities of the local community. The funds may be used to purchase services from the local vocational education system, but in this case for particular programs with demonstrated need. JTPA does not duplicate vocational education.

The budget policy to delete Federal vocational education grants will have no significant effect on the State and local system. The policy to add $1 billion to JTPA is designed to attack two critical problem areas for which alternative assistance is limited -- the needs of dislocated workers and the problem of youth unemployment. The $980 million program for dislocated workers will help them find jobs through counseling, retraining, or relocation assistance. The the proposed 1987 level) will allow local areas under JTPA to design remedial education and training programs directed to helping those most in need of assistance -- youth in welfare families. Local areas also will be able to finance summer jobs for these youth if that is a priority.

These decisions, like all budget decisions, were made on the basis of intensive analysis and recommendations by the program agencies, carefully reviewed with them by OMB and finally decided on in the context of the overall budget priority-setting and decision-making process.

Job training legislation will be submitted within the next few weeks.

Are the Education Cuts Fair

QUESTION:

Mr. Miller, when the Budget was released last week, Secretary Bennett at the Department of Education said that the Department of Education must share the burden of reducing domestic budget deficits. This is a principal many of us agree with; all facets of Federal spending must pitch in to meet this country's fiscal responsibilities. Federal education spending which is well supported and represents about two percent of annual Federal expenditures, would be forced to bear 29 percent of the overall domestic spending cuts proposed by the Administration.

Mr. Miller, do you believe the Federal spending cuts have contributed to our deficit to the extent where they must bear 29 percent of the spending cuts proposed by the Administration?

ANSWER:

The size and composition of the budgets proposed for each agency are the product of a long and careful process of analysis of each program's goals, appropriateness within this Adminstration's policies, effectiveness and efficiency. There is no process which allocates some fixed percentage of budget savings to a given agency.

The budget amounts proposed for programs in the Education Department are "fair" because they represent the results of this analysis and, if enacted, would be consistent with the Administration's policies.

Education Department spending accounts for only about six percent of national spending on education. The bulk of the spending is provided by those levels of government traditionally and properly most responsible for the funding and direction of education, the States and localities. The Budget provides ample funding for those programs where the Federal role is clear and the programs are most likely to carry out their goals most effectively and efficiently.

Fiscal 1987 Rescissions

QUESTION:

Your are asking for nearly $3 billion in rescissions from recently enacted fiscal 1987 appropriations for the Departments of Labor, Health and Human Services and Education. That's nearly 10 percent of the discretionary appropriations for these Federal agencies that provide "safety net" services; protect the health of our nation and educate and train our citizens for productive careers.

- Didn't you recommend that the President sign these appropriations into law last fall?
- Do you intend to promptly release these funds as soon as these rescissions expire?

ANSWER:

The President was not presented with a Labor-HHS-Education appropriations bill to sign into law last fall. Because the Congress was unable to reach agreement on any of the thirteen appropriations bills, it presented the President with a single, omnibus, full-year Continuing Resolution, after the start of the fiscal year, which he had no alternative but to sign.

As the President has said on frequent occassions, the whole appropriations process makes it very difficult to address levels for individual programs. Extremely unwise levels for certain programs may be contained in bills which, for a variety of reasons, the President must sign. A line-item veto authority, similar to that available to and exercised routinely by many Governors, would eliminate this problem and thus eliminate the necessity for proposing many of the rescissions.

The rescissions proposed to the Labor-HHS-Education bill accounts are primarily proposed because they represent spending not needed and are therefore available to withdraw to help slow down expenditure growth. The majority of the funds proposed for rescission operate in a forward-funded manner, so that most of the outlays resulting from this budget authority would occur in 1988. Enactment of these rescissions is essential to make room for other proposals in the Budget and still meet the Gramm-Rudman-Hollings target of a deficit no larger than $108 billion for 1988.

If the Congress fails to enact the rescissions before the expiration of the 45-day period, the funds will be released promptly to the agencies for obligation as required by law.

QUESTIONS SUBMITTED BY SENATOR DECONCINI

Customs Service Policy Deferral

QUESTION:

Can you explain for the Committee this rather unusual procedure for addressing specific Customs drug interdiction initiatives that were approved by Congress and the President only three months ago?

ANSWER:

The Administration does not believe that the budgets proposed for the Customs Service air interdiction program in 1987 and 1988 use "unusual procedures" to address the overall drug interdiction initiative. The FY 1988 Budget proposes to spend all of the 1987 funding provided by the Congress. Total 1987 and 1988 spending of $257 million represents a massive increase over 1985 and 1986 levels (an average increase per year of more than 70% since 1986). Moreover, the Administration's detailed spending plan for 1987 and 1988 differs only slightly from the plan contemplated by the Congress. In 1987, the Administration and the Congress agree on increases in the tracking and interception mission. We also agree on most detection increases.

The differences between us are in two areas -- technical and policy differences. The technical costing differences mainly pertain to operating the E-2C aircraft in 1987 for a partial year, revised Treasury estimates of the costs necessary to establish three C-3I centers, and additional funding made available by the Administration for more frequent operations of general support and tracking aircraft.

The policy differences pertain to the establishment of a fourth C-3I center in Oklahoma City, which the Administration believes serves no useful purpose in improving air interdiction capabilities, and further equipment modifications of tracking aircraft, which the Administration believes is not necessary for their continued performance. The Administration had shifted the authority to obligate funds ($19 million) to modify P-3 aircraft with 360 degree radar from the first quarter to the second quarter of FY 1987. The Administration took this action while awaiting completion of a study by the National Drug Enforcement Policy Board dealing with the feasibility and cost effectiveness of this modification. While the Drug Policy Board has not made a final determination on this project, these funds have been legally available for obligation since January 1, 1987.

As part of the FY 1988 Budget, the Administration recently submitted supplemental appropriations language to the Congress for the Customs air program. This language proposal seeks to withhold the obligation of approximately $32 million in no-year funds (enacted in FY 1987) until FY 1988. I assure you that there will be no Executive Branch action to defer or otherwise restrict the funds currently available until after Congressional enactment of this proposal.

QUESTION:

Isn't this a classic example of a so-called policy deferral -- the type of deferral that you agreed not to do during calendar year 1986?

ANSWER:

No. We promised the Appropriations Committees last year that the Administration would not submit any policy deferrals to the Congress for the remainder of calendar year 1986. I have kept that promise. Moreover, the 1988 Budget proposed no policy deferrals, other than those associated with transfer requests to fund increased 1987 pay and retirement costs. Such policy deferrals are consistent with an understanding OMB and the Appropriations Committees reached shortly after the Impoundment Control Act was approved in 1974.

A classic policy deferral would involve administrative withholding of funds and a deferral report to the Congress. These funds would not be available for obligation until the deferral was completed or Congress took action to overturn the deferral. As outlined in previous answers to your questions regarding tne air interdiction program, there will be no Executive Branch action or inaction to defer or otherwise restrict the funds currently available. While the Administration has submitted supplemental appropriations language to the Congress requesting delay in obligating certain no-year funds until FY 1988, no action will be taken until after Congressional approval of this proposal. Unlike the "classic policy deferral", Congress, in this instance, must take action to delay the availability of funds.

Other Revenue Raising Agencies

QUESTION:

With this type of return on investment from these two revenue agencies (Customs and the Bureau of Alcohol, Tobacco and Firearms), why do you continue to cut them back, while I.R.S. enjoys seemingly unlimited growth?

ANSWER:

We do not agree that all revenue-collecting agencies are the same and should be treated equally. The largest revenue-collection agency, the Internal Revenue Service, has been able to document analytically a specific marginal relationship between different budget and personnel levels and the amount of tax revenue to be gained or lost. Given the emphasis placed on tax reform by the President and the Congress, the Administration believes that further strengthening IRS budget resources is of utmost importance in the FY 1988 budget process.

Unlike the Internal Revenue Service, the Customs Service has never documented, through analytical data, a relationship between overall budget and staffing levels and total revenue to be collected in a particular year. Total revenues collected by the Customs Service are not a product of overall budget and personnel resources, but rather a factor of general economic conditions and trade activity.

The type of revenues collected by the Bureau of Alcohol, Tobacco and Firearms (ATF) is similar to the Customs Service. Taxes monitored and collected by ATF are a result of the production and manufacturing activities in the alcohol and tobacco industries. Similar to Customs, ATF has not documented analytically any relationship between overall ATF budget resources and total revenues achieved.

Accompanying the FY 1988 Budget, we are proposing legislation to impose user fees (to provide additional revenue) for those private parties that benefit from services provided by Customs and ATF. The Customs user fee legislation will propose technical corrections to the Customs ad valorem fee, passed by the Omnibus Budget Reconciliation Act of 1986, which provided that importers of products with American-made components would not have to pay fees for Customs inspectional services. The Administration believes that private users of specific Government services should pay for those services. We estimate an additional $166 million in new user fees to be achieved in 1988.

We will also propose legislation for new user fees on liscensing and compliance activities provided by the Bureau of Alcohol, Tobacco and Firearms. The additional revenue in 1988 will be about $50 million.

Withholding Apportionments In Anticipation Of Rescissions/Deferrals

QUESTION:

How do you reconcile these concrete examples of OMB withholding appropriated funds in anticipation of deferrals or rescissions with your statements to me that this just doesn't happen, at least without Congress knowing about it?

ANSWER:

As I have written to you in earlier correspondence, OMB has not taken, and will not take under my leadership, any apportionment action to jeopardize the ability of agencies to obligate funds for authorized purposes within the term of availability for the funds in question. Contrary to what is assumed in the questions, my staff has followed this policy guidance. Let me provide some specific examples.

For the Customs Service air interdiction program, you suggested that OMB staff changed the first quarter, no-year funding apportionment in anticipation of a proposed "deferral" or "reprogramming". This is not correct. The difference between the requested and approved apportionments, approximately $19 million, is the amount available for modifying P-3 aircraft with APS-138 360 degree radar. As you know, the National Drug Enforcement Policy Board, chaired by the Attorney General, has been assessing the technical and engineering feasibility, as well as the overall cost effectiveness, of the proposed P-3 modification. The Drug Policy Board should complete the study and make a final policy decision on this issue in early February, 1987. Because the Drug Policy Board has not yet made a final decision on this matter, we believed it fiscally prudent to postpone obligating the no-year funds for this project until a decision was made during the second quarter of FY 1987. I would note, however, that since the second quarter of FY 1987 began on January 1, 1987, these funds have been legally available for obligation.

It has also been assumed that OMB improperly withheld nearly $32 million from the requested first quarter 1987 apportionment of the Customs Service salaries and expenses account and did not report this action to the Congress. This, too, is not correct. Funds were shifted among quarters within this apportionment to assure a more balanced level of obligations throughout the fiscal year, given the rescission proposal. As I have mentioned in earlier correspondence to you, this particular rescission proposal has been included in the President's report on rescissions and deferrals that accompanied the 1988 Budget submission to the Congress. Moreover, this specific apportionment action, along with other similar actions, was taken within the customary and generally accepted period of time needed to prepare the required documents for Presidential review and subsequent transmittal to the Congress.

Finally, you have suggested that OMB improperly withheld $15 million from apportionment in 1987 for the Bureau of Alcohol, Tobacco and Firearms (ATF). OMB did not withhold any ATF funds from obligation prior to December 31st, and OMB has not jeopardized the ability of that agency to obligate funds within their term of availability. The initial OMB apportionment for ATF did not constitute an impoundment of funds but, rather, reflected a difference of opinion about the estimated quarterly spending needs for that bureau.

Internal Revenue Service

QUESTION:

Can you tell the Committee when we can expect a point of diminishing returns for IRS spending? In other words, when will we have reached the point where throwing more enforcement money at the IRS will bear less "revenue" fruit than is currently projected?

ANSWER:

The Internal Revenue Service has a very important role to perform -- to collect taxes owed the Federal government. The IRS now collects more than twice the revenues from direct enforcement of the tax laws than it did six years ago primarily through improved productivity and procedural and technological changes. The Administration believes that such investments will produce needed additional revenues -- without raising taxes -- because a gap of about $100 billion exists between the amount of tax that should be paid and the amount of tax that is voluntarily paid.

The requested budget for the IRS reflects the importance of assessing and collecting taxes owed under law. Fairness to honest taxpayers and raising revenue go hand-in-hand. The FY 88 Budget requests an increase of about $400 million over currently appropriated levels for increased staff and automated data systems for enforcement efforts, which are expected to increase revenue collections by $2.4 billion.

The IRS is far from the point at which additional dollars spent on revenue initiatives would bring in less in additional revenues than they cost. The IRS estimates that it could, over time, employ fifty percent more personnel over the next ten to fifteen years before the theoretical "breakeven point" would be reached.

Other increases over current appropriated levels for the IRS are requested to cover the costs of uncontrollable items such as increased pay ($105 million), contributions to the new Federal government retirement system ($280 million), and implementation of tax reform ($80 million).

QUESTION:

What would be the effect on the Service's ability to prepare for the new tax bill if the Supplemental for IRS were reduced or denied by Congress? Be specific.

ANSWER:

The Administration and, I am sure, the Congress, considers implementation of the landmark tax reform legislation a national priority. The IRS must provide taxpayers with the information forms and the help they need to adjust to the new law. This is why we approved and support this $80 million Supplemental Request. The Service is absorbing $66 million in extra pay costs from the January three percent pay raise. If the Supplemental is denied, the Service could meet tax reform requirements by reducing auditing and collection programs. This, however, would make it impossible to achieve the additonal revenue collections planned, which contribute to reducing the deficit.

QUESTION:

What contingency plans have you made for the IRS to use if Congress provides less than the requested amount?

ANSWER:

My office supports the Supplemental Request for the IRS. I am confident that after Congress has had the opportunity to review and consider the IRS situation, you will support this request. However, in the event that Congress should provide less than the amount requested, the IRS would have to reduce tax enforcement programs to avoid cuts to mandatory tax reform requirements.

QUESTION:

What would a reduction in the Supplemental Request do to revenue estimates for fiscal year 1987, if anything.

ANSWER:

The Service estimates that for each dollar reduction to spending on revenue initiatives planned for FY 87, nine dollars of increased revenue collections would be lost. Thus, if the Supplemental were reduced by half, to $40 million, the revenue loss to the Treasury would be about $360 million.

Government-Wide Pay Raise Assumptions

QUESTION:

Could you tell the Committee how you decided which agency received pay raise supplementals and which did not?

ANSWER:

OMB instructions to Executive Branch agencies in

November 1986 required full absorption of the January 1987 pay raise whenever possible. Agencies were directed to absorb these increased costs within an account, through existing transfer authority, or through transfers proposed between accounts within the agency. In cases where full absorption was not possible, agencies were required to submit specific justification for any amount not absorb.

These justifications were reviewed carefully in the context of overall requirements for 1987 for the agencies involved. For example, the Department of Justice is seeking pay supplementals for the FBI and DEA in order to ensure that the investigative and enforcement activities of these programs are not hampered. In other instances, some small agencies lacked the flexibility or ability to absorb these increased costs. Other agencies were able, for example, to use existing transfer authority or to propose transfers between accounts that would permit absorption of these costs. In general, decisions to seek pay supplementals were made on a case-by-case basis.

QUESTION:

Can you assure this Committee without qualification that no such policy decisions went into OMB's decision to provide pay raise supplemental relief to certain agencies?

ANSWER:

In reviewing agency requests for pay supplementals, OMB was mindful of the Gramm-Rudman-Hollings requirement for the Congress to find offsets for any additional supplemental requests. In light of this requirement, every effort was made to hold down the number and amount of these requests.

As stated on the response to the previous question, pay supplemental requests received close scrutiny and decisions were made based on the justification provided by agencies. In the case of pay supplementals, I can assure you that there was no overall OMB policy to require full absorption for agencies that received Congressional add-ons and to provide relief for other agencies.

Executive Office of the President

QUESTION:

How in the world can you justify increases of nearly four times inflation for the White House staff and OMB when law enforcement agencies, education, and other programs are being slashed?

ANSWER:

The budgets for the Executive Office of the President, with few exceptions, reflect FY 87 appropriated levels adjusted upward only for increased costs of the Federal Employee Retirement System (FERS), the cost of the FY 87 pay raise and SLUC (rent) rate increases. The percentage increase for the Executive Office is higher than for some other government agencies because of the higher proportion of personnel costs to total costs in the Executive Office. The percentage increases required to meet these increased costs within the Executive Office varies because of differences in staff composition and the amount of SLUC rate increases. The entire 12.4 percent increase for the White House Office is to meet increased costs of FERS, pay and SLUC.

After adjusting for increases for FERS, the FY 87 pay raise and SLUC rates, the increase for the Office of Management and Budget including the Office of Federal Procurement Policy (OFPP), is less than 3.5 percent. The Administration is requesting an increase of approximately 50 percent for OFPP. This signals a renewed emphasis on procurement reform. The increase would provide for additional professional staff to permit OFPP to play a more active role in the reform process. The Administration is convinced that the procurement process, which is responsible for expenditures of more than $200 billion annually, needs to be made effective and efficient.

President's Budget Reform Plan

QUESTION:

Dr. Miller, you have indicated to me in my office that the President intends to submit several proposals for reforming the Congressional budget process, including line item veto; accelerated rescission process; two-year budgeting; and a proposal for making the concurrent budget resolution a joint resolution that would require the President's signature. There may be other items that we did not discuss in any detail.

> Q: Could you outline for the Committee the specific planks in the President's budget reform platform and tell us how each is intended to improve the way we do our budgeting business?

ANSWER:

Proposals for reform of the budget process continue to be considered within the White House, but to date have not been completed.

Balanced Budget and Line-item Veto Amendments

The President has indicated his support for a constitutional amendment requiring a balanced budget, and for a constitutional amendment or legislation to provide the President with line item veto authority. Various proposals were considered to implement these ideas during the 99th Congress. The President would welcome the opportunity to work with the Congress toward enactment of such legislation. Enactment of Balanced Budget Amendment, including line-item veto authority would serve as a disciplinary device reversing the institutional and political incentives in favor of excessive spending.

Enhanced Rescission Authority

There are various possible approaches to implement enhanced rescission authority. Each would modify the authority provided by the Congressional Budget and Impoundment Control Act of 1974.

Two-year Budgeting

Two-year budgeting would reduce the current overload of budgetary decisions and would improve the management of many government programs. The 1988 provides two-year requests for all defense spending. These two-year requests were required by the Congress, a move I strongly support. The appropriate next step would be to consider other areas of the government where a shift to two-year requests would be expected to lead to improved program management. Given a broader test; we may find that two-year budgeting would be appropriate for the government in general.

Joint Resolution on the Budget

A proposal to shift the current concurrent resolution on the budget to a joint resolution on the budget has the potential advantage of converting the Congressional budget resolution into a budget of the United States government. The shift to a joint resolution would force a political agreement between the Congress and the President earlier in the budgetary process, facilitating subsequent action on individual budgetary bills.

Credit Reform Proposals

The Administration will transmit a legislative proposal and detailed budget amendments to implement a reform in the budget treatment of federal direct and guaranteed loans early in March. The purpose of these proposals is to accurately measure the economic implications of government loan programs and to facilitate choices between spending and lending programs. Part 3B of the 1988 Budget and Special Analysis F to the 1988 Budget describe this proposal in greater detail.

Two Year Appropriations

QUESTION:

What would be OMB's official position on providing two years worth of appropriations in our appropriations bill this year?

ANSWER:

Biennial budgeting is a budget tool that requires additional study before it should be expanded in any comprehensive manner. In addition the Administration is currently not in the position to provide additional estimates of appropriations needed for fiscal year 1989, simply because decisions leading to such estimates have not been made.

Two Year Appropriations

QUESTION:

In your estimation, what would be the Budget Act of Gramm-Rudman-Hollings impediments to providing 1988 and 1989 money in appropriation bills this year?

ANSWER:

There are no Gramm-Rudman-Hollings impediments to providing 1988 and 1989 appropriations in the 1988 appropriations process. However,it should be noted that the 1989 amounts listed by account in the 1988 budget except for DoD, Military and certain other accounts identified in the Budget by account and agency, are planning numbers only and do not represent Administration requests. These planning numbers were not derived in accordance with the 1989 GRH deficit target. Any appropriations made for that year should be done in the context of the 1989 deficit target.

QUESTION:

What are the Administration's goals and legislative plans for increasing the collection of overdue non-tax debts owed to Uncle Sam? Be specific and tell us how much additional debt you intend to collect in fiscal 1988 over 1987. (GAO estimates non-tax debt balance of $24 billion as of 1985.)

ANSWER:

While substantial progress has been made toward achieving a sound and comprehensive credit management program, a great deal remains to be done. Specific goals of the Administration's credit management program are to:

- Establish a Credit Reform Program that will allow the Government to manage its credit activities more effectively by selling most loans as soon as they are extended. This will promote good credit management by focusing the Government's attention on screening applicants, documenting loans to commercial standards, and reducing the burdens of loan servicing and collection.

- Implement a sound, comprehensive Nine Point Credit Management Program in each agency, focusing efforts on the most critical requirements involving the origination, servicing, and collection of loans and accounts receivable. As part of this effort, an absolute reduction in the $68.3 billion delinquent debt portfolio will be achieved in the next two years.

Implementation of the Debt Collection Act and other key credit management tools is being accomplished by a performance goal process. OMB, in coordination with Treasury, sets time-phased, measurable goals, for key aspects of debt collection and credit management in major credit agencies. Targets are also set for reduction of the delinquent debt portfolio and increased collections in each agency. Goal setting is integrated in the annual OMB review of agency budget requests, ensuring coordination of resource requirements and collection estimates and imposing the discipline of the budget process on agency achievement of debt collection goals.

The sheer size of the Federal Government's portfolio and the volume of its lending shapes and often distorts the nation's credit markets. The Administration's Credit Reform Program and Nine Point Credit Management Program seek to correct these distortions by reducing delinquent debt and providing sound credit management for federally administered loan programs.

For the record, I believe it is important to recognize that not all of the $26.4 billion in outstanding non-tax delinquent debt reported as of September 30, 1986 is readily collectable. Foreign delinquent accounts reported by the Agency for International Development, the Export-Import Bank, and the Defense Department total $2.1 billion. These loans are subject to national security consideration, rescheduling, and other adjustments to these loans that are managed on a multi-lateral basis with our allies. The consequences of recent dislocation in the farming, shipping and oil industries is reflected in $10 billion in delinquent debt reported by Agriculture and $1.4 billion reported by the Maritime Administration. These deliquencies are requiring us to develop individual credit management strategies. The Farmer's Home Administration accounts for much of the Agriculture deliquencies, and their collection efforts have been impeded by a statutory prohibition on use of private collection firms.

Finally we have identified a significant amount of the debt that is uncollectable due to bankruptcy, death, and disability. These accounts will be written off.

Question:

Why is the Administration backing off its "public" support for the omnibus drug bill provisions, only three months after signing it into law with such great fanfare?

Answer:

The President is dedicated to fighting for a Drug-Free America. From the beginning of this Administration, the First Lady has served as a champion for this cause. Thanks to this strong Presidential support, resources for drug law enforcement have tripled between 1981 and 1988, while funding for prevention and treatment have increased by 52 percent. In just two years, from 1986 to 1988, overall drug spending has increased by 34 percent. Compared with 1987, the 1988 Budget requests funding for over 1,000 new drug investigators, prosecutors, and associated support staff, and will add approximately 800 new bed spaces to the Federal Prison System for drug violators.

Although much has been made of an apparent decline in drug funding in the President's 1988 Budget, in fact, total government spending, as measured in outlays, actually increases every year, even from 1987 to 1988, the years of the so-called cuts. Outlays for 1988 will be $3,456 million, as compared to $3,020 million in 1987 and $2,152 million in 1986. The appearance of a funding reduction is created when one looks only at the bottom line budget authority, without understanding the details behind the numbers. Let us look at those details:

- Over $350 million provided by Congress in 1987 will purchase capital items, such as aircraft and the construction of intelligence centers, that simply don't need to be repeated year after year. Hence, this money is not requested in 1988. Nonrecurring capital purchases account for the INM decline from 1987 to 1988. The INM operating level will still be higher in 1988 than prior to the drug bill.

- The Budget proposes termination of a $225 million drug enforcement grant program to State and local governments. This one-time infusion of 1987 funds can assist the governments in starting programs and making initial purchases, but it need not become an on-going supply line. Congress added the grant program to the 1986 Anti-Drug Abuse Act over the objections of the Administration, which felt at the time that the activities envisioned by the grant were properly the responsibility of State and local governments to fund. Offsetting the need for this grant program, the Federal Government continues to share the proceeds generated by the asset forfeiture program, which in 1986 distributed $24 million to State and local police departments and is expected to award $28 million more to these agencies in 1987.

- Over $250 million of the HHS 1987 appropriation for drug abuse prevention and treatment will be spent over two years (1987 and 1988), as recommended by Congress, but the entire amount is "scored" in 1987. Thus, the 1987-1988 decline is overstated by almost $130 million.

- Finally, the Department of Education grant program, funded at $200 million in 1987, will be reduced to a level of $100 million in 1988. A higher level is needed in the first year for start-up activities, such as planning expenses and materials, and these initial expenses need not be repeated.

To summarize, actual government outlays for drug programs are increasing in every year of this Administration. To suggest that the President has abandoned his commitment to combatting drug abuse simply ignores the facts.

International Affairs/State Department Increases

QUESTION:

Why in the world should this Committee approve these huge percentage increases for the State Department when so many other agencies are being cut back substantially? Could you break out the details for us on the State Department appropriation increases, since we do not have the budget Appendix or individual agency justification available until January 28th?

ANSWER:

The Administration recognizes the difficult budget situation facing the Congress and realizes that each agency and department of government must attempt to maintain its programs with limited resources. The State Department has shared the reductions made to all agencies' budgets. 1987 funding for the Department's operations was $447 million less than the 1986 appropriated level of $2.41 billion. The Department's 1988 operations request of $2.62 billion is $560 million above the 1987 request level. Although this is a sizable increase, the Administration thinks it necessary to maintain the Department's overseas operations and the diplomatic security program at acceptable levels.

The requested increases for 1988 of $560 million include $137 million for mandatory increases such as domestic and overseas wage and price increases, and annualizations of 1987 increases, including $52 million for the new Federal Employees Retirement System (FERS); $112 million for program increases for ongoing programs and the diplomatic security portion of the salaries and expenses account. These increases include $4.8 million for the new Office of the Inspector General, $2.6 million to enhance the Department's diplomatic reporting capabilities, $25.5 million to enhance the Department's communications and information systems, and $5.8 million for other administrative and staff activities. Program increases for diplomatic security salaries and expenses total $74.2 million, including $10.6 million for communications systems, $61.8 million for overseas security operations, and $1.8 million for informations systems. Foreign building construction is increased by $311 million to maintain overseas buildings currently owned and leased by the State Department and to undertake new embassy replacement projects consistent with the Department's diplomatic security program.

USIA Funding Increase

QUESTION:

Why this big jump when most agencies are being cut back? Be specific since we do not have your budget detail documents as yet.

ANSWER:

USIA's 1988 request for Salaries and expenses of $642 million is $70 million more than its enacted level of $572 million, but only $53 million more than its 1987 total if the 1987 supplemental request for $16 million is included.

The bulk of the net 1988 increase in Salaries and expenses ($47 million or 87 percent) is for cost increases and mandatory changes. For example, included in this sum is $10 million for anticipated price increases, $13 million for increased retirement costs stemming from the new Federal Employees Retirement System, $6 million for foreign national wage increases, $5 million to annualize the 1987 Federal pay raise, $5 million in increased Voice of America (VOA) operating costs resulting from its modernization program, and $5 million to annualize the 1987 expansion of WORLDNET programming.

$7 million of the net 1988 increase is needed to extend WORLDNET television networks to Southeast Asia, East Asia, and Africa. This enchancement will fund an additional 46 positions that are needed to carry out the global plan for WORLDNET television.

State Department: Supplemental Request

QUESTION:

Why should we approve supplemental funding for State Department operations when other critical agencies are being forced to absorb FERS, pay, and in some cases, face recissions in program funding for FY 1987?

ANSWER:

The 1987 supplemental request for the Department of State includes requests that are either crucial to the overseas operations of the Department or are mandated by law. The requests for funds to staff the new Office of the Inspector General ($3.5 million) and to implement the provisions of the Immigration Reform Act ($3.1 million) are based on new responsibilities mandated by the Congress that cannot be absorbed within the Department's base. The $47.4 million requested to offset overseas inflation and exchange losses is justified by the dramatic depreciation of the dollar overseas during the past year. This request would only partially offset the exchange losses experienced by the Department, and would enable the Department to maintain overseas operations at current levels. The request for an American national gift to recognize the Australian Bicentennial ($5 million) and to meet program costs for U.S. participation in the Conference on Security and Cooperation in Europe (CSCE) ($800 thousand) are viewed by the Administration as important to U.S. foreign policy and, therefore, are included in the supplemental request to the Congress.

QUESTION:

About $1 billion of the President's proposed fiscal 1987 supplemental is for the initial cost of the newly-enacted Federal Employee Retirement System or FERS. It is clear from the President's proposal that not all agencies received supplemental funding to offset the increased cost of the new FERS program. The effect of this "selective" supplemental funding is, in some order to have enough money to pay for the supplemental FERS costs. Other agencies will have to postpone or defer permanently other critical program activities that were mandated by Congress and approved by the President just three months ago. Could you tell the committee exactly how OMB decided on which agencies would receive supplemental FERS funding and which agencies would not?

ANSWER:

In October 1986, OMB issued instructions to all departments and agencies that provided guidance on how FERS costs should be calculated and specified an overall absorption policy. The bulletin stated that agencies were expected to absorb the maximum amount possible of increased FERS retirement cost in 1987 and beyond. Agencies were also required to submit specific justification for any amount of FERS costs that could not be absorbed.

In setting out these ground rules, OMB was cognizant of the Gramm-Rudman-Hollings requirement for the Congress to find offsets for any additional supplemental requests. These pressures clearly served to hold down the number and amount of FERS supplemental requests included in the budget for 1987.

It is true that some agencies are seeking 1987 supplementals to cover FERS costs, while others are fully absorbing these costs. For example, the IRS is requesting $120 million in 1987 for FERS to help assure that its revenue raising capabilities or tax reform implementation efforts are not impeded. In other cases, some small agencies were found, on close examination, to lack the flexibility or capacity to fully absorb additional FERS costs. On the other hand, some agencies were able, for example, to use existing transfer authority or to propose transfers between accounts that would permit absorption of FERS costs. In general, agencies were examined on a case-by-case basis to determine the extent to which additional FERS costs could be absorbed.

QUESTION:

Can you say without any reservation or qualification that no policy decisions or actions by the Administration entered into OMB's decisions to provide supplemental FERS funding to agencies?

ANSWER:

In reviewing FERS, as well as pay, supplemental requests, we were keenly aware of the Gramm-Rudman-Hollings requirement that offsets be found for any additional supplemental requests. As a consequence, we made a strong effort to hold down the number and amount of these requests.

Generally, the FERS supplemental requests were examined closely and decisions were made based on the justification provided by the agencies. The predominant concern was, as we have stated, to avoid the need for finding additional offsets under Gramm-Rudman-Hollings.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

Federal Employee Retirement System

QUESTION:

I understand that OMB issued general assumptions for the use of all agencies in calculating increased agency contributions for employee retirement under the new Federal Employee Retirement (FERS). Will you please briefly summarize for the record the general assumptions issued by OMB for the purpose of estimating these increased retirement costs?

ANSWER:

Summary of General Assumptions for Calculation of Increased Retirement Costs

Participation. It is assumed that 40 percent of CSRS enrollees will switch into the new FERS between July 1, 1987 and January 1, 1988. (This assumption is incorporated in the percentages shown in table 1 of the Bulletin's Attachment A.)

Thrift Plan Utilization. Under the plan, agencies will contribute 1 percent of payroll for every FERS enrollee even if the employee contributes nothing. In addition, agencies must match 100 percent of employee's first 3 percent of pay contributed to the plan and 50 percent of the next 2 percent. Agency contributions to the Federal Retirement Thrift Investment Board for the thrift plan will be assumed to be static, in percentage terms, over the 5-year estimating period.

Agencies are to use the following actuarial projections regarding employee contributions to the thrift plan for FY 1987-1992. Specifically, they are to utilize a 3 percent total contribution on behalf of post-1983 hires, and a 4 percent total contribution on behalf of the population switching into FERS. (These rates include the 1 percent contribution required for every FERS enrollee and incorporate the impact on post-1983 hires' contributions of changes in employer matching contributions, maximum contributions, and effective dates included in the Omnibus Budget Reconciliation Act of 1986.)

Timing of Enrollment. Under FERS, agency contributions to social security (i.e., to the Federal old-age and survivors and disability insurance trust funds, known as OASDI), and the civil service retirement fund will begin January 1, 1987 for post-1983 hires. Contributions to the Thrift Investment Board for the thrift plan will begin the first pay period in April, 1987 for these employees. For estimating purposes, it is assumed that half of the current CSRS enrollees who will switch will do so July 1, 1987. The remaining half will do so December 31, 1987.

FERS-Covered Population. The amount of agency contributions will be determined by applying the percentages spelled out in the Bulletin to the payroll attributable to the 3 populations identified as post-1983 hires, switchers, and CSRS enrollees. These populations may vary by agency but should not be substantially different from the Government-wide averages specified in the Bulletin.

(A copy of OMB Bulletin 87-2 is attached for your information.)

QUESTION:

How many agencies, if any, demonstrated that these assumptions did not appropriately apply to their payroll?

ANSWER:

The agencies were permitted to demonstrate that government-wide averages for the FERS-covered population were not applicable to either the entire agency or a particular account within an agency. All other assumptions concerning participation, thrift plan utilization rates and timing of enrollment were required to match assumptions in the bulletin.

The OMB did not collect information centrally on agencies or accounts within agencies permitted to vary from the standard assumptions concerning FERS-covered populations.

QUESTION:

What is the total FY 1987 supplemental appropriation request associated with these new retirement costs? What are the FY 1987 outlays associated with that request?

ANSWER:

The budget requests $1,019 million in supplemental appropriations for these new retirement costs. The budget also requests transfer authority to fund these costs. The outlays in 1987 for these supplemental appropriations are estimated to be $1,086 million.

QUESTION:

It is my understanding that agencies were expected to absorb as much of the increased retirement costs as possible in FY 1987. What percent of these costs are being absorbed in FY 1987? What would be the total FY 1987 appropriation requirement for these costs if no absorption were assumed? What would be the total outlays in FY 1987 associated with this funding?

ANSWER:

OMB did not keep a central tally of all agency requests for increased retirement costs due to the Federal Employee's Retirement System (FERS). During the midsession review of last summer, we had estimated $1.4 billion would be necessary in 1987 for increased contributions to the Civil Service Retirement and Disability Fund and the Thrift Savings Fund due to FERS. These estimates were reflected in the mid-session review estimates.

OMB recently asked the major agencies to provide information on increased retirement costs in 1987 for FERS. The resulting information is attached.

QUESTION:

What is the total FY 1988 requirement necessary to fully fund these retirement costs?

ANSWER:

The OMB has not collected this information centrally. The detailed agency budget justifications for 1988 to be provided to Congress, however, will include estimates of the total costs of retirement benefits associated with the President's proposed program levels.

QUESTION:

If the assumptions used to calculate these increased agency contributions for employee retirement fall short of estimating the actual costs, will the Administration submit a supplemental funding request?

ANSWER:

We recognize that actual costs for the new retirement system may differ from our current estimates for a wide variety of reasons. If our current assumptions consistently underestimate these costs for 1988, we will examine the need for supplementals as we develop the 1989 budget. It is also possible that our assumptions could overestimate costs. To moot that contingency, we have prepared general provision language to permit any excesses to lapse at the end of 1988.

Gramm-Rudman-Hollings - Fiscal Year 1987 Supplemental

QUESTION:

On another aspect of Gramm-Rudman-Hollings compliance, I am curious about why your supplemental request is not offset by your proposed rescissions so as to make the entire package deficit neutral. Again, I am aware that your counsel asserts that the provisions of Gramm-Rudman-Hollings do not legally require you to submit a deficit-neutral proposal. But it is indisputably true that the Senate may not consider a supplemental that is not deficit neutral, unless there are 60 votes to waive that particular Gramm-Rudman-Hollings rule.

I did not support Gramm-Rudman-Hollings. You did. Knowing that any supplemental considered in the Senate must be deficit neutral, do you really expect us to act favorably on your supplemental request for defense and foreign aid when you cannot even propose a way to make the measure deficit neutral? After all, it is relatively easy to propose such things as $2.5 billion in rescissions for education programs, but much harder to vote for them and be held accountable for them.

-- Why did you not propose rescissions and deferrals of sufficient magnitude to offset your supplemental request? Do you not care if we fail to offset a supplemental, and thereby increase the deficit? Are you tacitly admitting that it would not be prudent to rescind any more funds than you have proposed? The administration is constantly bashing Congress for supposedly wasteful spending -- couldn't you find enough of it to rescind?

ANSWER:

You are correct that the items proposed by the Administration for consideration by the Appropriations Committee are not deficit neutral. However, the items proposed by the President for action by all the committees of the Congress plus other administrative actions are not only deficit neutral, but the Executive Branch proposes to reduce its outlays by almost $200 million in 1987 in order to compensate for supplementals proposed by the Judicial and Legislative Branches. The description of the items included in the Administration's proposals are detailed below (in millions of dollars):

Item	Budget Authority	Outlays
Supplementals:		
Pay:		
Wage board	11	12
Civilian	185	281
Military	*	5
Subtotal	196	298
Retirement contributions	1,019 1/	1,086
Proposed transfers out for pay and retirement contributions (deferrals)	...	-92
Supplementals under existing law	292	178
Supplementals requiring legislation	3,009	977
Subtotal, supplementals	4,516	2,447
Proposed legislation (to be submitted later)	792	-305
Total, supplementals and proposed legislation	5,308	2,142

Item	Budget Authority	Outlays
Offsets		
Retirement offset....................	-1,019 1/	-1,086
Proposed rescissions.................	-5,685	-1,058
Administrative action................	-100	-50
Receipt legislation..................	...	-81
Total offsets......................	-6,804	-2,275
Net effect............................	-1,496	-132

Note: Details may not add to totals because of rounding.

1/ Excludes $67 million of limitations on obligations.

Explanation of Offsets to Fiscal Year 1987 Supplementals

Retirement Offset

The supplementals requested for retirement contributions are for payments made by employing agencies to one of the Federal employee retirement trust funds. Because these are intra-governmental payments, which are offset by receipts of the trust funds, they do not affect total budget authority, total budget outlays, or the budget deficit. They are properly deductible from the supplemental totals when measuring the effect of the supplementals on the budget totals.

Proposed rescissions

The amounts shown as offsets are the reductions in budget authority and outlays associated with rescissions proposed by the President.

Administrative actions

The Administration plans to implement regulations that are projected to reduce 1987 outlays for Medicaid and Medicare by a total of $50 million in 1987. Specifically:

- o Medicaid

  - --- Medicaid quality control regulation. This regulation would simplify the method for determining error rate projections for States and establish performance-based criteria for evaluating States' request for waiver of error rate liabilities. Saves $10 million in 1987.

  - --- Payments to institutions regulation. Currently States are required, on a selective basis, to pay for medical services not covered by Medicaid. This regulation proposes to give States discretion to decide, on a uniform basis, whether or not to assume the cost of such medical services. Saves $5 million in 1987.

--- Reimbursement for drug regulation. Under the proposed rule, three methodologies are developed to set Federal Medicaid drug payments at a level equivalent to the lowest transaction cost. States retain the flexibility to use their own methodology. Saves $25 million in 1987.

- Medicare

  --- Durable medical equipment. This regulation proposes to pay the "lowest charge level" for selected durable medical equipment. Saves $10 million in 1987.

Receipts legislation

The Administration is proposing legislation to increase governmental receipts from customs user fees to cover the cost of processing documents related to imports with American made components and to cover the costs of the Nuclear Regulatory Commission and the Federal Emergency Management Agency for regulating nuclear power plants.

* * * *

The Administration has found a way to offset the high priority supplementals for national defense, foreign aid, retirement increases, and pay raises. The Administration does care about the deficit and has submitted responsible proposals for 1987 and 1988. We trust that the Congress will find offsets in other areas of the Budget if it chooses not to approve any of the proposed offsets.

Deficit Impact of Proposed Fiscal Year 1987 Supplementals, Rescissions, and Deferrals

QUESTION:

Are the Fiscal Year 1987 total outlay savings from the rescissions and deferrals proposed by the Administration sufficient to offset the Fiscal Year 1987 outlay impact of the Administration's supplemental funding requests?

ANSWER:

The outlay savings from the rescissions and deferrals are not sufficient to offset the Administration's supplemental funding requests. However, the Administration's total proposed program for 1987 is deficit-neutral.

QUESTION:

What is the total Fiscal Year 1987 outlay impact of the Administration's supplemental funding requests? What is the total Fiscal Year 1987 outlay savings from rescissions proposed? What is the total Fiscal Year 1987 outlay savings associated with deferrals proposed?

ANSWER:

The following table summarizes that portion of the Administration's 1987 request requiring action by the Appropriations Committee (in millions of dollars):

	Budget Authority	Outlays
Pay raise supplementals (including Legislative and Judicial Branches)..	196	298
Retirement contributions (including Legislative and Judicial Branches) (no net effect).....................	(1,019)	(1,086)
Supplementals under existing law (including Legislative and Judicial Branches)..........................	292	178
Supplementals requiring authorization.	3,009	977
Proposed rescissions.................	-5,685	-1,058
Deferrals............................	...	-92
Proposed legislation in appropriations language............................	...	-214
Total............................	-2,188	90

QUESTION:

Mr. Miller, the 1988 budget request again includes a statement of your goal to both modify the repayment policy for the PMA's and ultimately to "defederalize" or sell these agencies including the Bonneville Power Administration.

First, in regard to the repayment schedule for the Bonneville Power Administration, last September, northwest consumers for the third consecutive year made a payment of over $600 million to the U.S. Treasury. Bonneville is current on all its payments to the Treasury. Nevertheless, the budget indicates that a "legislative effort will be undertaken to permit repayment reform..." During his confirmation hearings and also in last year's appropriation hearing, Secretary Herrington pledged that repayment reform would be initiated only after enactment of legislation to change existing policy. Is that your position?

Will this remain the Administration's view for the remainder of your tenure in office?

ANSWER:

Bonneville's claim that it is "current" in its repayments has little meaning. When Bonneville makes this claim, it is comparing actual repayments with planned repayments. However, because there is no fixed schedule to require predictable and stable repayments to the Treasury, Bonneville can revise its repayment schedule every year. When Bonneville is unable to make principal repayments, it merely postpones the repayments to future years and revises its repayment schedule to reflect the postponement. As a result, Bonneville was able to make principal repayments of less than $10 million per year, on average, over the 15 years from 1970 through 1984, while Bonneville's debt to the Treasury grew from $2.7 billion to $8.0 billion. This dramatic increase in debt was not in the best, long-term interests of the taxpayers or Bonneville's customers. As you noted, Bonneville did make significant payments in 1985 and 1986, in part due to the threat of Administration and Congressional action.

The Administration plans to submit legislation that would require the establishment of a fixed repayment schedule for the PMA's, beginning in 1989. This would establish a clear, predictable and stable level of repayments to Treasury to ensure that Bonneville's recent success in making debt repayments will be a permanent, not a temporary, practice. We are proposing to accomplish this change through legislation to provide for Congressional involvement in developing and authorizing the fixed repayment policy. However, it is our view that much of the change could be accomplished under existing law.

QUESTION:

With regard to so-called "defederalization", the budget assumes that divestiture or sale of the assets of these agencies, including BPA, will not begin until 1989. Due to the legislative prohibition enacted in the 1986 Supplemental Appropriations bill, it seems clear that legislation is necessary to spend funds on even the study of divestiture of the PMA's. Do you agree? What process do you envision following in moving to your goal of sale of these agencies?

ANSWER:

It is our view that legislation is required to authorize funds for undertaking detailed studies designed to provide divestiture of four of the five power marketing administrations. Study activities have been underway for the Alaska Power Administration, which is not covered by the prohibition, and those activities are continuing.

If Congress provides the necessary authorizations, the Administration would proceed in a spirit of cooperation with the Congress in an open process, and would consult with existing power customers before developing any detailed divestiture proposals. We do not anticipate recommending any specific divestiture action unless it could be shown that such action would be beneficial to both existing PMA customers and Federal taxpayers. In particular, contrary to many allegations, we do not believe that divestiture would lead to significant increases in power rates.

This general approach is reflected in the Department of Energy's activities on the Alaska Power Administration. Municipalities and rural electric cooperatives in Alaska have been cooperating with the study, and they have made a number of very helpful suggestions which are being seriously considered. The Alaskan municipalities and rural electric cooperatives looked at the prospect of defederalization of Alaska Power as an opportunity rather than a threat, and have been willing to consider and discuss possible divestiture in a constructive manner.

The Department of Energy hopes to initiate a similar study for the Southeastern Power Administration. The President's budget proposes legislative language to authorize the study. The study process would involve the active participation of the current customers, and the study results, along with any recommendations for further action, would be transmitted to the Congress for its review. No implementation action would be undertaken without subsequent Congressional authorization.

QUESTION:

Why does the administration's 1988 budget submission fail to met the Gramm-Rudman-Hollings deficit targets for the outyears, 1989-1991?

ANSWER:

The most important figure -- and the one that the act requires be met -- is the target for the budget year, in this case FY 1988. The Administration has chosen to highlight the programmatic and revenue changes needed now to get next year's deficit down to $108 billion. The changes that the Administration has proposed will also lead to substantial reductions of the deficit in subsequent years. If those savings are achieved, the task we face next year when we will present the specific proposals needed to meet the target for 1989 will be much easier than the task we faced this year. We are confident that it is possible to reach the GRH targets -- both in 1988 and in the outyears -- without a tax increase.

TWO YEAR BUDGETS

QUESTION:

If estimates can vary that much in such a relatively short period of time, what can we expect over a two-year period? Do you have any thoughts on how these fluctuations can be controlled so as to avoid swamping the calendar with legislative adjustments to a two-year budget?

ANSWER:

The vast majority of the $29B by which the 1987 GRH target will be missed result from two sources: one, changes in economic conditions from when the budget was originally proposed and now, (the effect of these changes could be in either direction, up or down) and two, increases in unappropriated entitlement programs e.g. C.C.C. Changes of these type do not affect and are not affected by the appropriation cycle be it one year or two.

QUESTION:

Again this year, Mr. Miller, the President's budget message indulges in criticizing Congress in a way that is gratuitous at best and offensive at worst. Specifically, on page 13 of the President's budget message, reference is made to last year's continuing resolution, which was recommended to the President for his signature, as a "slap-dash resolution" that was "full of excessive and wasteful spending." Further, the President asserts that he had to accept "many objectionable features" of the CR, in order to avert a federal funding crisis.

Not only is this Congress-bashing gratuitous and counter-productive to the working relationship necessary to responsibly conduct the nation's business, it is simply not accurate. You and your associates were closely involved in the negotiations that produced that continuing resolution. Specific provisions, such as those on agriculture, received your specific approval. The conference on the measure consumed a full week. Floor consideration of the conference report took two days in the Senate. That is hardly slap-dash. As for signing the bill to avoid a "funding crisis", I suspect it had much more to do with the President's finding that the CR offered him a very good deal. He's never appeared averse to funding crises before. And if it was "full of excessive and wasteful spending", why can't you find enough in proposed rescissions to offset your supplemental request? Throwing away the taxpayer's money in a tax reform bill goes by the benign name of "transition rule." When it comes to appropriations, all you can talk about is waste and excess.

Can we count on you to moderate this sort of language, and foster a bipartisan relationship that serves the public interest, not short-term political gain?

ANSWER:

The Administration is committed to a reform of the budget process that serves the public interest. We believe that this end will best be served by recognizing the flaws and shortcomings of the current budget system and working through them in a bipartisan relationship.

Working together, the Administration and Congress need to begin to explore ways in which the budget process itself can be reformed and improved. Many Members of Congress feel that the system through which budget decisions are made is not working the way it should, and the Administration shares that view. Its deficiencies, unfortunately, are reflected in the results. Deadlines for congressional action too often are missed or ignored; the threat of a government-wide shutdown has become an almost regular feature of the beginning of fiscal years; and the end product of this process remains a Federal budget that provides for excessive spending and a large deficit. The Administration is committed to working with the Congress to establish procedures to encourage cooperation rather than confrontation between the Executive and Legislative branches on the crucial issues of Federal spending and to adopt measures that will help make the budget process more responsible and more accountable.

The Administration will again propose that the Congress adopt a Balanced Budget Amendment to the Constitution and the establishment of a line-item veto. Adoption of a Balanced Budget Amendment would represent our acceptance of a simple yet fundamental principle -- the Federal government must live within its means. A line-item veto would further enhance our capacity to reduce and eliminate wasteful and redundant expenditures.

QUESTIONS SUBMITTED BY SENATOR WEICKER

NATIONAL INSTITUTES OF HEALTH

QUESTION:

The Administration proposes to extend the availability of funds appropriated for the National Institutes of Health. In practical terms, that means deferring $334 million that Congress intended you to spend on research this year.

I understand that proposed supplemental langauge States "there will be no Executive Branch to defer or otherwise restrict the funds currently available until after congressional enactment of this proposal". However, I am told the Department of Health and Human Services plans to cut grant budgets inorder to insure the availability of the $334 million should Congress approve the request to extend the use of FY87 funds into FY88.

What assurances can you give this committee that no N.I.H. funds or grants will be withheld or reduced without specific legislative authority to do so?

ANSWER:

The President has requested that Congress permit the National Institutes of Health (NIH) to obligate $334 million, or about 5.5 percent of its fiscal year 1987 appropriation, in fiscal year 1988. This proposal is part of the President's long-term policy of providing stable and sustainable support for NIH.

NIH has the administrative discretion to determine how best to manage spending during the fiscal year based on the programmatic goals of NIH. Under the current NIH spending plan, research project grants are being awarded in a manner that will place NIH in a position to implement the intent of Congress with respect to the NIH appropriation, but also the President's revised budget policy should Congress agree to the Administration's proposal. NIH will not take any action that would inhibit its ability to obligate fully all funds appropriated for fiscal year 1987 in a programmatically effective manner.

All noncompeting continuation grants continue to be awarded as they come due in accordance with the normal grant cycle. On average, the current amount awarded for each project represents a 3 percent increase over fiscal year 1986 rather than the 11 percent that would be possible under the appropriation. Depending on the congressional response to the President's proposal, future increases are possible. New and competing grants are being awarded at a rate that would permit NIH to comply with either the proposed 5,654 level or the 6,354 number possible under the appropriation. On average, new and competing awards reflect an average 10 percent increase over fiscal year 1986 rather than the 17 percent possible under the appropriation. Again, depending on the congressional response to the President's proposal, future increases are possible.

These programmatic adjustments are consistent with earlier uses of NIH's administrative discretion to manage its spending plans during the course of a fiscal year.

The President's proposal would take effect only when the Congress approves the supplemental appropriations language submitted to the Congress on January 5th. Should Congress not accept the President's proposal for extended availability, NIH could make supplemental awards to grantees.

Department of Education Budget

QUESTION:

Mr. Miller, the Department of Education sent up a budget proposal for fiscal year 1988 of $14 billion, a reduction of $5 billion from the amount Congress appropriated for FY 1987. I understand that the $14 billion figure is derived from a $14.7 billion outlay ceiling the Department was given by the Office of Management and Budget.

o Can you tell us what considerations were taken into account in determining the Education ceiling and why you chose to make such drastic cuts in Education?

ANSWER:

The budget for the Education Department, like the budgets for all agencies, is arrived at after careful consideration of the appropriateness of the programs within the policies of the Administration, their efficiency and effectivenesss, consideration of alternative, less costly methods to achieve the goals, and the overall fiscal situation.

All agencies, in this Adminstration and in all Administrations, receive a planning ceiling at the start of the budget process. That ceiling is generally derived first, by projecting the next year's spending that would result if the Administration's budget year policies were enacted. These projections are then adjusted in any number of ways based, for example, on known starting or ending dates of major projects, economic assumptions, expiration of authorizations, explicit decisions this year on outyear program growth or contraction, and the like.

The final decisions on the Education budget were, as always, based on a composite, unique to every agency, of agency and OMB recommendations, the overall fiscal situation and other factors.

This Administration's views on Education Department spending have been expressed consistently in every budget: the Federal role in the financing of education is limited to areas where the Federal responsibility is clear (e.g., for supplementary services for the disadvantaged and handicapped; for the poor in post-secondary education; for high quality national level research and statistics). The 1988 Budget for Education Department programs is consistent with this policy.

Almost two-thirds of the cuts in Education funding, for example, are for student aid, where our policies would provide about the same level of aid as is now available, reduce the Pell grants for virtually no poor student, but substantially reduce the cost to the taxpayer.

In another example, smaller reductions in programs for the handicapped and disabled would in fact still provide increases in 1987 over 1986 and in 1988 over 1987. They would, however, eliminate the unwarranted increases enacted for 1987.

The cuts in Education Department programs are not drastic. They are based on reasonable and responsible estimates of the amounts appropriate to carry out needed programs properly.

RAILROADS

QUESTION:

Mr. Miller, my understanding is that the budget totals for railroad safety represent a sixteen percent reduction from the FY87 level. Just yesterday the Transportation Appropriations Subcommittee held a hearing on the most recent Amtrak accident and railroad safety. The Administration has stated its commitment to rail safety. Doesn't the budgetary reality fly in the face of the Administration's rhetoric?

ANSWER:

No. Congress appropriated $27,050 thousand for railroad safety in 1987. Excluding railroad research and development which the Administration proposes to include in the railroad safety account in 1988, the President's Budget includes a comparable railroad safety level of $29,376 thousand, an eight percent increase over 1987. For railroad research and development which is primarily concerned with railroad safety, Congress appropriated $9,581 thousand in 1987. The President's Budget includes a comparable railroad research and development level of $9,923 thousand in 1988, a three percent increase over 1987. In addition, the President's Budget provides for a new safety specialist concerned solely with alcohol and drug problems in the railroad industry.

QUESTION:

With regard to Amtrak, the Administration wants to both eliminate the subsidy and sell the railroad. The last Senate vote on eliminating the subsidy was quite lopsided (25-71) against such a move. The House also is committed to this passenger railroad. Why then do you propose to eliminate intercity railroad passenger service in the country?

ANSWER:

In light of the Federal Government's fiscal austerity, Amtrak subsidies should not be continued. Since 1970, the Federal Government has provided Amtrak with more than $12 billion in direct and indirect subsidies. After more than 15 years of operation and despite a virtual monopoly on intercity rail passenger service and a subsidy averaging $27 per passenger in 1986, Amtrak serves less than 0.5 percent of all intercity travel. The Administration continues to believe that provision of rail passenger service should not be a Federal responsibility and service that is either economically viable or essential to States would be picked up by non-Federal entities.

The Administration believes that elimination of Amtrak's Federal subsidy is the proper policy choice. It is Congress' right to agree or disagree with the President's proposal. However, the President's budget is based on what he believes is right -- but not necessarily on what is likely to be popular on the Hill.

URBAN MASS TRANSIT

QUESTION:

Also, urban mass transit is slotted for a 58 percent cut. Congress has demonstrated a commitment to this program as well. In 1985, the Senate voted down by 25-72 an even more modest cut. Why do you think Congress would go along with such a drastic reduction?

ANSWER:

We propose: to limit transit funding to receipts from transit's one-cent share of the fuel tax; to eliminate the general-funded transit discretionary program; and to distribute transit trust funds by formula. Congress should adopt our program for reasons of fairness, cost effectiveness and budget constraint.

Our program is fair because it would distribute transit's share of the fuel tax by formula to all States, compared to the current discretionary approach which cause about 39 States to receive less transit assistance than they contribute in gas tax collections. By ending the discretionary program, raising the local matching share and limiting operating assistance to areas under 200,000 in population, we would encourage more cost-effective local transit investments. The growing evidence of poor capital planning and utilization, unrealistic project design and cost estimation and the prospect of inadequate local funds to operate systems once constructed, all suggest that a reduction in the level of transit capital assistance might improve the cost-effectiveness of local transit systems.

Our proposal is budgetarily sound because it would establish transit as a solely user fee funded program consistent with efforts to fund the vast majority of transportation programs through user fees, not general revenues. By eliminating transit's general fund support and limiting transit spending to proceeds from one-cent of the fuel tax, transit programs would not add to the nation's deficit problem.

Finally, as mentioned with regards to Amtrak, our budget is based on what we believe is right, not necessarily on what is politically palatable to Congress.

Question:

What has become of this Nation's commitment to developing our marine resources? Mr. Miller, this reduction could eventually cost us more than the $50 million it saves in FY88. How can you explain OMB's proposed elimination of these programs?

Answer:

The President's proposal to terminate the Sea Grant and Coastal Zone Management State Grants programs asserts that the Federal objective of both programs has been achieved and the States and other local interests should now accept responsibility for any continued funding.

Under the CZM program, grants were provided to coastal States to develop and administer programs that protect and develop their coastal areas. The program was not intended to provide perpetual support of State programs. This program has achieved its goal by successfully developing the infrastructure to manage these resources. The 29 states covering 94 percent of the Nation's coastline have operational Federally-approved programs. From 1972 to 1986, more than $500 million has been spent to develop this capability. These programs can now be directed and supported locally. I would emphasize that the President's Budget does include funding for research and protection of biologically important estuarine areas, as well as for evaluation of State CZM programs and monitoring of Federal activities to encourage consistency with State plans.

Similarly, the Sea Grant College program was designed to create a network of colleges and universities with strong programs in marine education and research. That goal has been achieved. Approved programs are in place in 21 colleges and 8 institutions around the country covering all 30 coastal states and Puerto Rico. More than $460 million has been awarded these institutions since the inception of the program. Sea Grant College programs have been oriented toward satisfying primarily local, state, and regional needs and fifteen State legislatures now appropriate funds explicitly for Sea Grant studies and research. Responsibility can now be transferred to those interests which are the program's primary beneficiaries.

Senator, I know that the National Undersea Research Program (NURP) is of special interest to you; however, we do not believe that NURP is central to NOAA's mission. The resource development activities are largely of private, state, and regional concern and should not be competing with high priority national needs for limited Federal funding.

Further, I am concerned that while other domestic discretionary programs (including other NOAA programs) have been asked to slow down their rate of growth or not grow at all, the funding for NURP has almost tripled over the last five years.

Finally, our commitment to the Nation's marine resources is intact in the President's Budget. The President's request for 1988 for NOAA's Oceans and Atmospheric Research (OAR) and for the National Ocean Service (NOS) exceeds the President's request for 1987.

QUESTIONS SUBMITTED BY SENATOR GRASSLEY

NATIONAL INSTITUTES OF HEALTH

QUESTION:

With respect to the budget proposals for the National Institutes of Health, there appears to be some confusion.

According to the budget proposals, and the testimony by you before the appropriations committee yesterday, the administration plans to reduce the 1987 NIH appropriation by $334 million and to reduce the number of new and competing research grants in 1987 by 700. Now, you noted in your testimony before the appropriations committee that the administration would be sending up a deferral message on this money.

However, and this is where the confusion comes in, the President's Message transmitting a request for supplemental appropriations to the Congress, dated Janaury 5, says, on page 33, that, and I quote: "There will be no Executive Branch action to defer or otherwise restrict the funds currently available until after congressional enactment of this proposal." The "This proposal" in that quote refers to a proposal in that same document to fund a lower level of new and competing grants that the level authorized, and appropriated for, by Congress.

Now, what we need here, is some clarification. Is the Administration going to spend that money unless otherwise instructed by Congress, or is it going to defer spending that money?

ANSWER:

In mentioning a deferral, I was describing in general terms the President's request that Congress permit the National Institutes of Health (NIH) to obligate $334 million, or about 5.5 percent of its fiscal year 1987 appropriation, in fiscal year 1988. This proposal is part of the President's longterm policy of providing stable and sustainable support for NIH.

In addition to proposing extended availability of $334 million of the fiscal year 1987 appropriation for FY88 obligation, the President's stability policy includes a $2.8 billion request to cover the full, post-FY88 costs of new and competing grants awarded by NIH in 1988. Fully funding grant commitments when they are incurred focuses attention on the full cost of awarding additional grants and increases the flexibility of NIH program managers to respond quickly to rapidly emerging areas of scientific promise and public health need.

NIH has the administrative discretion to determine how best to manage spending during the fiscal year based on the programmatic goals of NIH. Under the current NIH spending plan, research project grants are being awarded in a manner that will place NIH in a position to implement the intent of Congress with respect to the NIH appropriation, but also the President's revised budget policy should Congress agree to the Administration's proposal. NIH will not take any action that would inhibit its ability to obligate fully all funds appropriated for fiscal year 1987 in a programmatically effective manner.

All noncompeting continuation grants continue to be awarded as they come due in accordance with the normal grant cycle. On average, the current amount awarded for each project represents a 3 percent increase over fiscal year 1986 rather than the 11 percent that would be possible under the appropriation. Depending on the congressional response to the President's proposal, future increases are possible. New and competing grants are being awarded at a rate that would permit NIH to comply with either the proposed 5,654 level or the 6,354 number possible under the appropriation. On average, new and competing awards reflect an average 10 percent increase over fiscal year 1986 rather than the 17 percent possible under the appropriation. Again, depending on the congressional response to the President's proposal, future increases are possible. These programmatic adjustments are consistent with earlier uses of NIH's administrative discretion to manage its spending plans during the course of a fiscal year.

The President's proposal would take effect only when the Congress approves the supplemental appropriations language submitted to the Congress on January 5th. Should Congress not accept the President's proposal for extended availability, NIH could make supplemental awards to grantees.

SLIDE 1

HIGHLIGHTS OF PRESIDENT'S FY 1988 BUDGET

- Meets FY 1988 Gramm-Rudman-Hollings deficit target of $108 billion — a reduction of $65 billion in FY 1988, following a reduction of $48 billion in FY 1987.
- Avoids increasing the Nation's tax burden.
- Reflects bipartisan consensus to protect Social Security.
- Provides 3 percent real growth in funding for National Defense (that is, 3 percent real growth above FY 1987 appropriated level).
- Reforms, reduces, or terminates an assortment of programs, saving taxpayers $19 billion in FY 1988 alone.

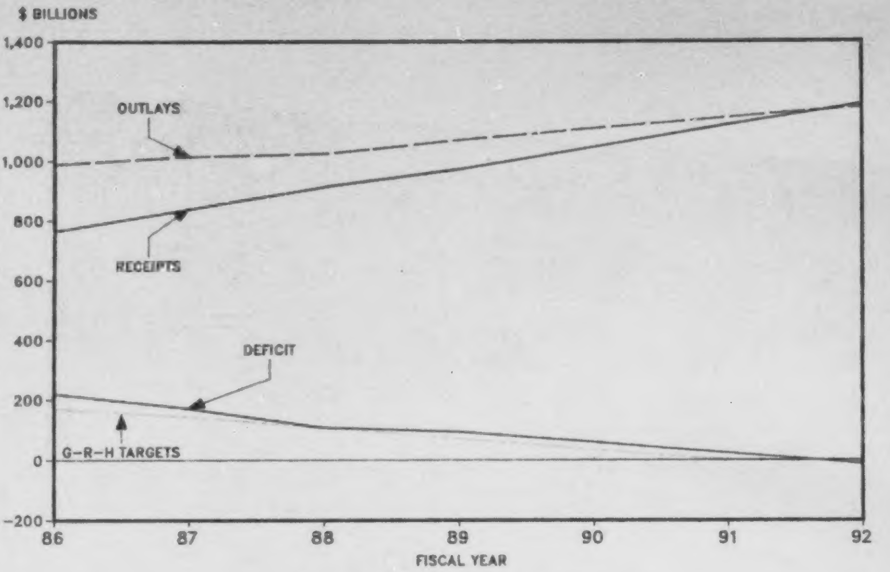
SLIDE 2

PRESIDENT'S FY 1988 BUDGET
(In billions of dollars)

	Fiscal Year						
	1986	1987	1988	1989	1990	1991	1992
Totals:							
Receipts	769.1	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
Outlays	989.8	1,015.6	1,024.3	1,069.0	1,107.8	1,144.4	1,178.9
Deficit or surplus	−220.7	−173.2	−107.8	−92.8	−59.5	−21.3	+12.3
Gramm-Rudman-Hollings targets	−171.9	−144.0	−108.0	−72.0	−36.0	0.0	0.0
Year-to-Year Changes:							
Receipts	35.0	73.3	74.2	59.6	72.1	74.9	68.1
Outlays	43.5	25.8	8.8	44.6	38.8	36.6	34.5
Deficit	−8.5	+47.5	+65.4	+15.0	+33.3	+38.2	+33.6

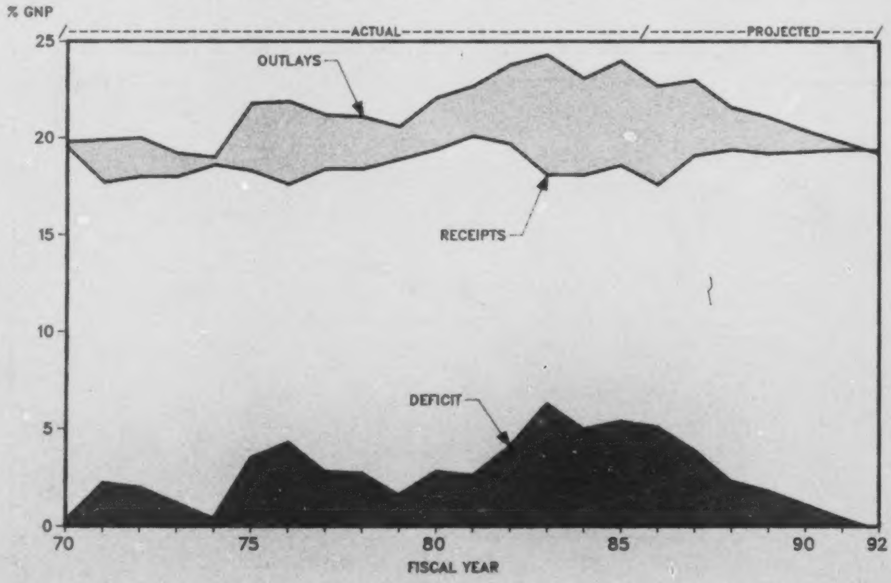
SLIDE 3

OUTLAYS, RECEIPTS, DEFICITS AND G–R–H TARGETS



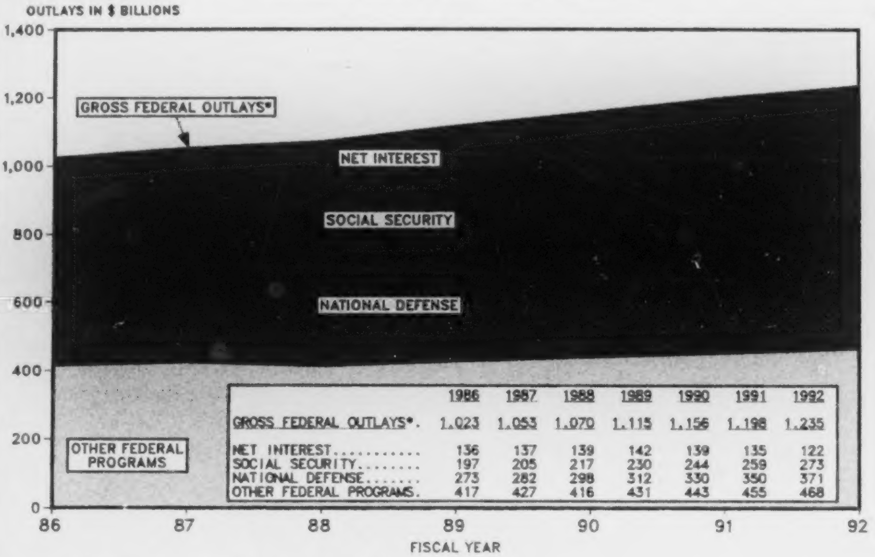
SLIDE 4

OUTLAYS, RECEIPTS, AND DEFICITS AS PERCENT OF GNP



SLIDE 5

MAJOR BUDGET COMPONENTS

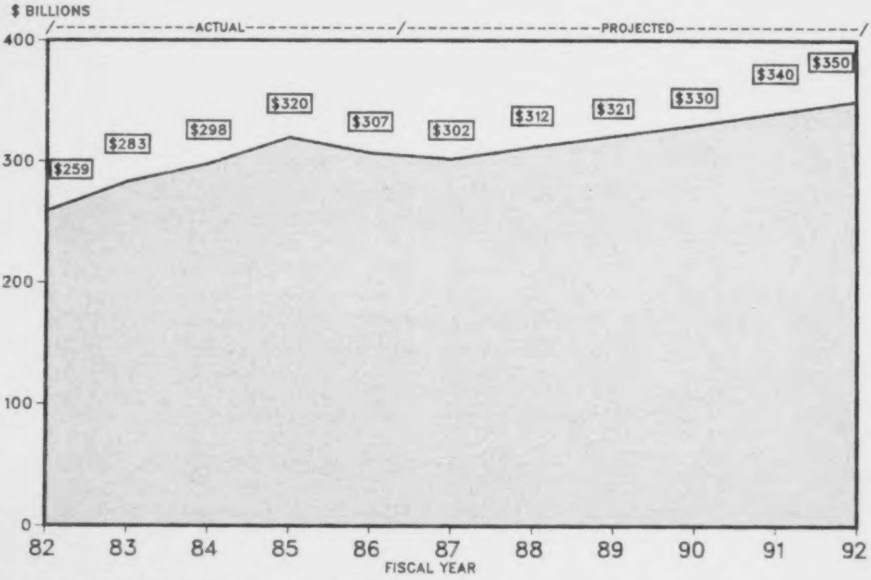


	1986	1987	1988	1989	1990	1991	1992
GROSS FEDERAL OUTLAYS*.	1.023	1.053	1.070	1.115	1.156	1.198	1.235
NET INTEREST...........	136	137	139	142	139	135	122
SOCIAL SECURITY........	197	205	217	230	244	259	273
NATIONAL DEFENSE.......	273	282	298	312	330	350	371
OTHER FEDERAL PROGRAMS.	417	427	416	431	443	455	468

* BEFORE SUBTRACTING UNDISTRIBUTED OFFSETTING RECEIPTS

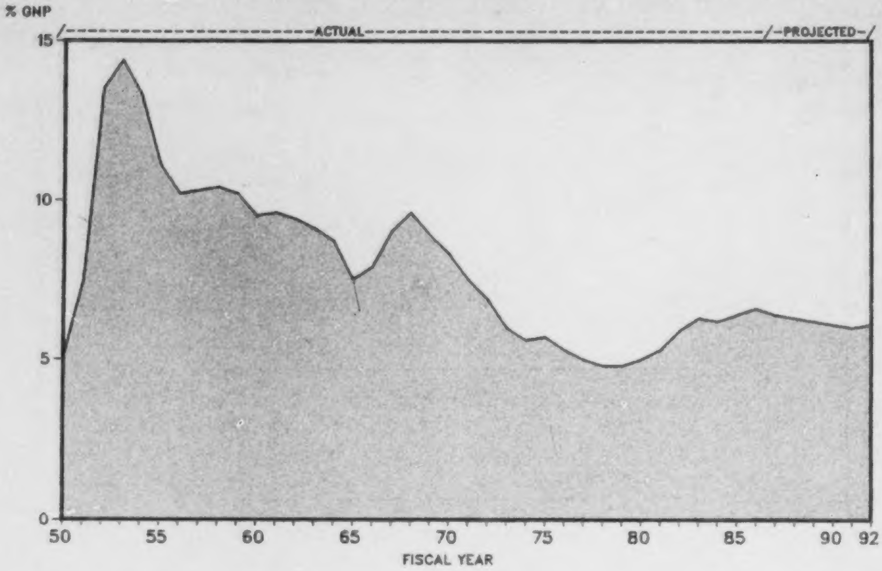
SLIDE 6

DEFENSE BUDGET AUTHORITY IN CONSTANT (1988) DOLLARS



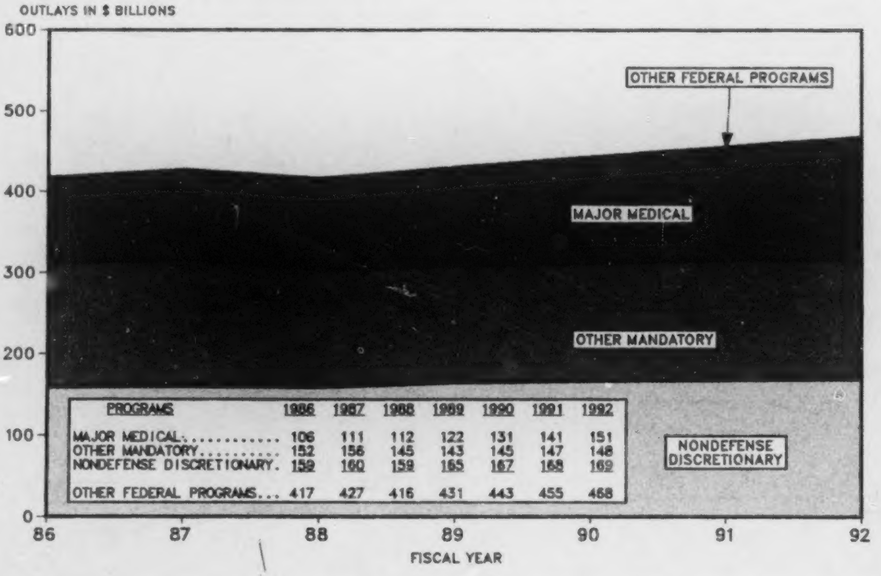
SLIDE 7

DEFENSE OUTLAYS AS PERCENT OF GNP



SLIDE 8

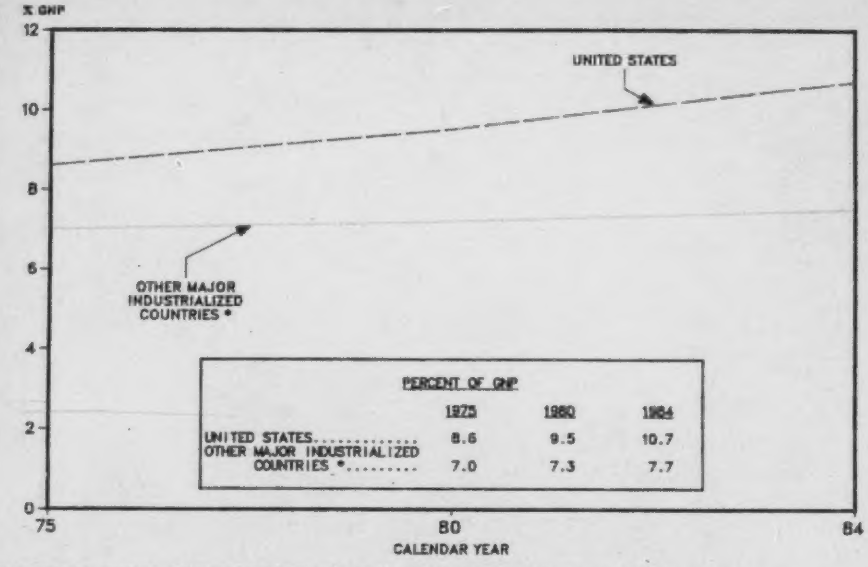
CONTENT OF OTHER FEDERAL PROGRAMS



PROGRAMS	1986	1987	1988	1989	1990	1991	1992
MAJOR MEDICAL............	106	111	112	122	131	141	151
OTHER MANDATORY..........	152	156	145	143	145	147	148
NONDEFENSE DISCRETIONARY.	159	160	159	165	167	168	169
OTHER FEDERAL PROGRAMS...	417	427	416	431	443	455	468

SLIDE 9

HEALTH COSTS AS PERCENT OF GNP, 1975–1984

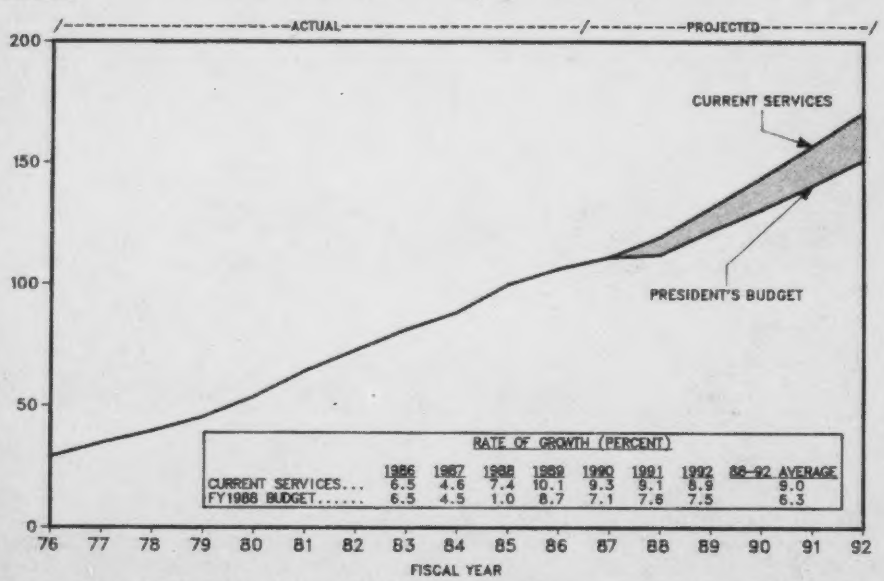


	PERCENT OF GNP		
	1975	1980	1984
UNITED STATES..............	8.6	9.5	10.7
OTHER MAJOR INDUSTRIALIZED COUNTRIES *..........	7.0	7.3	7.7

* AUSTRALIA, CANADA, FRANCE, WEST GERMANY, ITALY, JAPAN, NETHERLANDS, AND UNITED KINGDOM

SLIDE 10

OUTLAYS FOR MAJOR MEDICAL PROGRAMS*

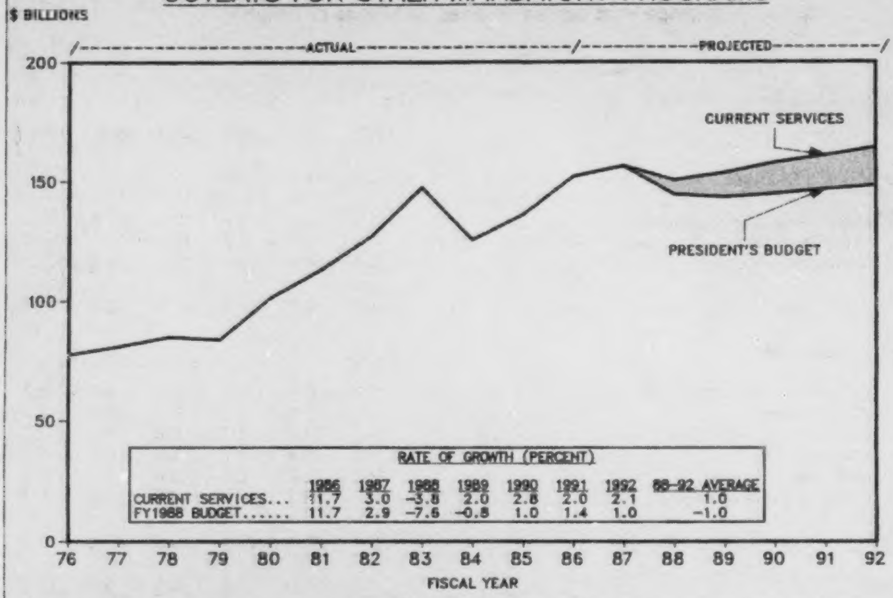


	RATE OF GROWTH (PERCENT)							
	1986	1987	1988	1989	1990	1991	1992	88–92 AVERAGE
CURRENT SERVICES...	6.5	4.6	7.4	10.1	9.3	9.1	8.9	9.0
FY1988 BUDGET......	6.5	4.5	1.0	8.7	7.1	7.6	7.5	6.3

* INCLUDES MEDICARE, MEDICAID, FEDERAL EMPLOYEE HEALTH BENEFITS, HOSPITAL AND MEDICAL CARE FOR VETERANS, AND INDIAN HEALTH CARE.

SLIDE 11

OUTLAYS FOR OTHER MANDATORY PROGRAMS*



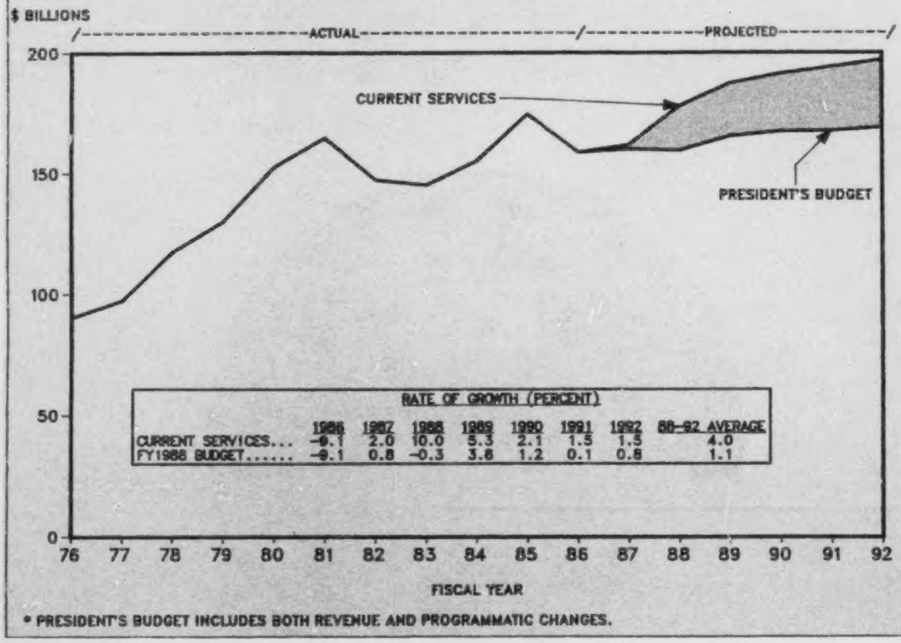
RATE OF GROWTH (PERCENT)

	1986	1987	1988	1989	1990	1991	1992	88-92 AVERAGE
CURRENT SERVICES...	11.7	3.0	-3.8	2.0	2.8	2.0	2.1	1.0
FY1988 BUDGET......	11.7	2.9	-7.6	-0.8	1.0	1.4	1.0	-1.0

* INCLUDES FEDERAL RETIREMENT PROGRAMS, LOW-INCOME SUPPORT, UNEMPLOYMENT BENEFITS, GUARANTEED STUDENT LOANS, GI BILL, FARM PRICE SUPPORT, AND OTHER MANDATORY PROGRAMS.

SLIDE 12

OUTLAYS FOR NONDEFENSE DISCRETIONARY PROGRAMS*



RATE OF GROWTH (PERCENT)

	1986	1987	1988	1989	1990	1991	1992	88-92 AVERAGE
CURRENT SERVICES...	-9.1	2.0	10.0	5.3	2.1	1.5	1.5	4.0
FY1988 BUDGET......	-9.1	0.8	-0.3	3.8	1.2	0.1	0.8	1.1

* PRESIDENT'S BUDGET INCLUDES BOTH REVENUE AND PROGRAMMATIC CHANGES.

SLIDE 13

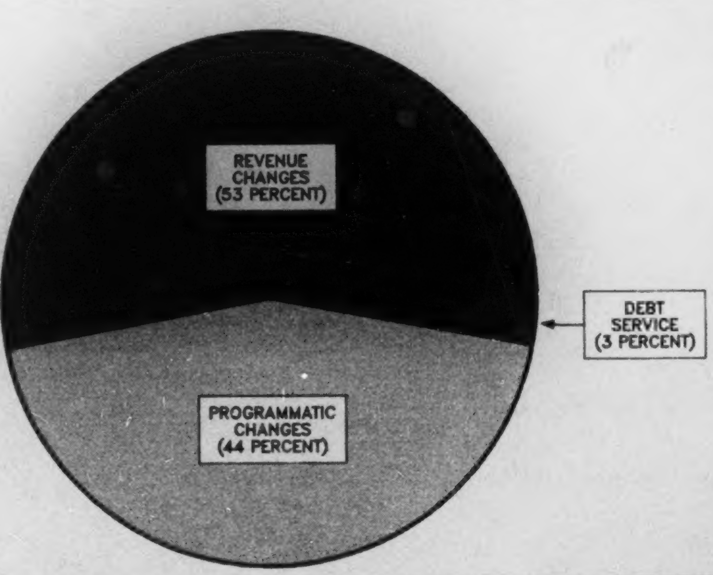
SUMMARY OF DEFICIT REDUCTION PROGRAM
(change from current services, in billions of dollars)

	Fiscal Year					
	1987	1988	1989	1990	1991	1992
Programmatic Changes:						
Major medical programs	0.1	6.7	7.7	10.0	11.8	13.9
Other mandatory	0.1	3.4	8.2	11.4	13.1	13.9
Nondefense discretionary	0.7	8.6	15.0	19.3	24.2	27.3
Total, programmatic changes	0.9	18.7	30.8	40.8	49.1	55.1
Revenues Changes:						
Governmental receipts	0.1	6.1	8.0	8.6	8.8	8.9
Credit reform	—	1.3	0.6	−0.9	−2.2	−3.6
Other loan asset sales	—	4.2	1.7	0.8	0.3	*
Privatization	0.1	5.4	3.7	3.8	6.5	5.3
User fees	0.3	3.2	3.5	3.6	3.7	3.8
Other revenue changes	—	2.1	2.6	3.6	4.3	6.7
Total, revenue changes	0.4	22.4	20.1	19.5	21.5	21.2
Interest	*	1.3	3.2	6.0	9.3	14.3
Total, deficit reduction	1.3	42.4	54.2	66.2	79.9	90.6

*$50 million or less.

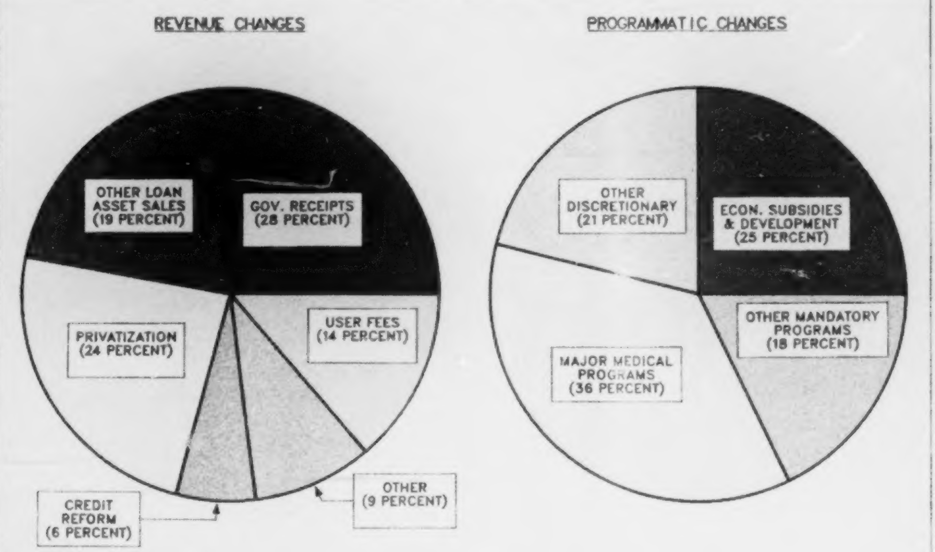
SLIDE 14

SOURCES OF DEFICIT REDUCTION, FY 1988



SLIDE 15

SOURCE OF DEFICIT REDUCTION BY CATEGORY, FY 1988



CONCLUDING REMARKS

Chairman STENNIS. It appears to me that this has been a mighty good hearing and a lot has come around here in a short time. I would like to thank the excellent witness we have. He seems to like his work, which is all easy to him. This budget matter is very complex. We used to think that, and I tell Mr. Chiles that we used to think that it was complex in the budget war, and we created a separate Budget Committee, and now he is the head of it, and now it is impossible almost.

But you gentlemen do good work on your end in handling these matters. The volume, the volume of the whole thing, the number of subjects that we have gotten into and thought we had to get into most of them, it is almost appalling. We have got the biggest stakes than any other country in the world and some of the best opportunities, so we are going to stay with it.

COMMITTEE RECESS

With the thanks of the committee to the Doctor and his group, we will take a recess now subject to the call of the Chair. Thank you very much.

Mr. MILLER. Thank you.

[Whereupon, at 12:22 p.m., Wednesday, January 21, the committee was recessed, to reconvene at the call of the Chair.]

BUDGET OVERVIEW FOR FISCAL YEAR 1988

THURSDAY, FEBRUARY 19, 1987

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 9:33 a.m. in room SD–192, Dirksen Senate Office Building, Hon. John C. Stennis (chairman) presiding.

Present: Senators Stennis, Chiles, Burdick, Sasser, Reid, Hatfield, Stevens and D'Amato.

CONGRESSIONAL BUDGET OFFICE

STATEMENT OF HON. RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

OPENING STATEMENT OF CHAIRMAN STENNIS

Chairman STENNIS. Will the committee please come to order. Ladies and gentlemen, we have many items on our agenda today here and all over Capitol Hill, you might say. There are a number of meetings going on, and some of them may conflict. Many of the members belong to several different groups that are meeting today. All I can say about that is, we just have to do the best we can.

We have what we believe is very important, valuable testimony of Dr. Penner here, and it is certainly worth hearing. Those who don't get to hear it, I strongly advise them to familiarize themselves with the points made because I believe that the turn-out of the testimony will be helpful to anyone who has a problem with trying to understand difficult decisions we will make later this year as the budget process goes forward.

As far as I can, I want to accommodate everyone as to time for each of you to ask at least some questions. Any assignment of time less than 10 minutes is difficult to abide by.

I have prepared here a brief statement. In the interests of time, I am going to ask that it be included in the record and printed with my remarks. I will try to come back to it along with some questions later in the hearing.

I want to point out that members of this group here include a number of far-reaching members in their schedules of work, and I am proud that they did come to the hearing. I think they should be rewarded.

INTRODUCTION OF DR. PENNER

Dr. Penner, I have already said that you are certainly welcome here, and we appreciate the services you have rendered already. We are sorry to learn that you are planning to make a change soon, but you won't be away altogether; you will still be with us.

I thank you for the highly valuable work that you have done. I have been impressed with it. Without further ado, again, because of the time, I am going to call on you to proceed now, Dr. Penner, and we will come back.

Senator STEVENS. Mr. Chairman? I would like to just put in the record my questions to Dr. Penner so I can go to another hearing. I think this will be acceptable. I had some questions. If I can just submit them for the record?

Chairman STENNIS. That is the price you have to pay. You have to come back.

[Laughter.]

Chairman STENNIS. Without objection, the questions will be placed in the record for proper attention, and I hope he does get back soon.

We want to pay courtesy here to the former Chairman of our Appropriations Committee and call on him now if he has remarks.

Senator HATFIELD. Thank you, Mr. Chairman. No, I would like to hear Dr. Penner and then ask questions later.

Chairman STENNIS. All right. Senator Chiles, do you have any matters, being the Chairman of the Budget Committee? That is the biggest thing in town.

Senator CHILES. Mr. Chairman, I am here to listen.

Chairman STENNIS. All right.

PREPARED STATEMENT

Dr. Penner, you have the Chairman wishing to hear you. You proceed in your own way. Without objection, my remarks will be placed in the record at this point.

[The statement of Chairman Stennis follows:]

STATEMENT OF HON. JOHN C. STENNIS

U.S. SENATOR FROM MISSISSIPPI

This morning the Appropriations Committee begins the second of the overview hearings on the President's proposed budget for fiscal year 1988. Today we will hear from Dr. Rudolph G. Penner, Director of the Congressional Budget Office, who will present his analysis of the administration's budget and the President's proposals for deficit reduction.

Later this month, we will have a hearing at which time the Honorable James A. Baker III, Secretary of the Treasury, will discuss the state of the economy and present the administration's view of its 1988 budget proposal.

It is a privilege for me to welcome you, Dr. Penner, to this committee and to these proceedings. Before we begin, I would like to take a moment to commend you and the Congressional Budget Office for the excellent analysis which you have provided in your two-volume report: The Economic and Budget Outlook: Fiscal Years 1988–92 and Reducing the Deficit: Spending and Revenue Options. Your report is a scholarly treatise which has provided great insight into the President's proposed budget for fiscal year 1988. We all look forward to hearing your presentation.

As many of my colleagues know, I accepted this chairmanship with the idea of establishing goals and priorities which will, hopefully, enable this committee to work with the administration in bringing the Federal budget deficit under control. As one who has had the distinct honor to have served as a member of this committee for the past 32 years, I am especially mindful of the challenge our country, this Congress, and our committee face today as we confront the first trillion dollar budget request ever submitted by a President.

However, I am concerned, as we confront this budget request, that we in the Congress remain mindful of our solemn obligation to act in a timely and meaningful way toward the orderly presentation of the 13 major appropriations bills. As we all know, the 1985 Balanced Budget Act—popularly known as Gramm-Rudman-Hollings—requires that Congress complete action on a concurrent budget resolution by April 15 and that the House of Representatives complete action on all regular appropriations bills by June 30. Although there is no deadline set out in the act regarding Senate action on appropriation bills, it is my fervent hope and strong intention that this committee, and we in the Senate, act in a timely fashion to complete the appropriations process by October 1.

I am equally concerned that this committee and the Congress adopt a budget plan for 1988 with a deficit no larger than $108 billion. I say this because, as your annual report indicates, Dr. Penner, and I quote from page 1 of part II:

> "The Balanced Budget and Emergency Deficit Control Act of 1985 . . . instructs the 100th Congress to adopt a budget plan for 1988 with a deficit no larger than $108 billion. But if the policies left in place by the 99th Congress are continued by its successor, the likely deficit for 1988 will be $169 billion. . . .
>
> Unless the maximum deficit targets prescribed in the Balanced Budget Act are amended, the budget resolution for 1988, which is due to be adopted by April 15, 1987, must close a gap of $61 billion. . . . That amount corresponds to a 5.7 percent cut in 1988 outlays or a 6.8 percent rise in revenues."

I am particularly struck by the implications of a failure to close this $61 billion gap For as your report states, Dr. Penner, and again I quote from page 1:

> "CBO estimates that the Budget Act's rules would force a 14 percent reduction in 1988 budget resources for national defense and a 20 percent cut in the unprotected non-defense programs."

In light of this succinct statement of the key issues before us, and the extraordinary implications of a failure to respond in an appropriate fashion, my colleagues and I look forward with great interest to your presentation this morning on the President's proposed budget. Please proceed.

CBO ANALYSIS OF PRESIDENT'S BUDGET PROPOSALS

Chairman STENNIS. Dr. Penner, please proceed.

Dr. PENNER. Thank you very much, Mr. Chairman. At the request of this committee, the CBO has prepared an analysis of the President's budgetary proposals for fiscal year 1988. We have distributed copies of the report, and I am very pleased to have the opportunity this morning to discuss it.

CBO analyzes the administration's budget in terms of changes from our own baseline. That baseline projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates or reprices, then, the administration's budget using CBO's economic and technical estimating assumptions and methods.

The differences between the baseline projections and the CBO estimate of the budget measure the effects of the administration's proposed policy changes.

Chairman STENNIS. Just a minute now. Let me interrupt to tell our members that we have copies of your statement here, and they are available. They are on the table before you.

Proceed.

FEDERAL DEFICIT

Dr. PENNER. We estimate that the Federal deficit under administration policy would be $134.4 billion in 1988, $117.1 billion in 1989, and $1.2 billion in 1992. These figures are noticeably higher than the administration's own deficit estimate. CBO's estimate for 1988 represents a reduction of $36 billion below our own baseline, but it is still $26.4 billion above the $108 billion target established by the Balanced Budget Act.

REESTIMATES

The reestimate for 1988 is slightly below the low end of the range of our preliminary analysis of the President's budget that we made a month ago. At that time, we estimated that the President's budgetary policies would produce a deficit within the range of $135 billion to $140 billion.

Our new estimate of $134.4 billion can be attributed almost entirely to the administration's plan not to provide advance deficiency payments on 1988 crops during fiscal year 1988.

Table 2 of my testimony, Mr. Chairman, divides the CBO reestimates of the President's budget into those resulting from different economic assumptions and those resulting from technical factors. Most of the reestimates are economic.

Although the differences between CBO and administration economic assumptions are relatively small, they affect the budget estimates substantially.

CBO's economic assumptions increase the estimated deficit by $4.2 billion in 1987, $15 billion in 1988 and $20 billion by 1992.

As shown in table 3 and discussed in chapter two of the full report, CBO assumes consistently lower real economic growth, higher interest rates, and faster inflation than does the administration. The first two factors tend to increase estimated deficits, while the third tends to lower them. Lower real economic growth holds down tax receipts, while increasing outlays for unemployment insurance and related programs.

CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1987 to $86 billion in 1992. Higher interest rate assumptions increase debt service costs by a negligible amount in 1987 and by growing amounts later. Faster inflation increases most revenue sources but only raises some outlay categories. It, therefore, reduces the estimated deficit by $3 billion in 1987, $8 billion in 1988 and $84 billion in 1992.

DEFENSE AND NONDEFENSE SPENDING

CBO bases its estimate of defense and nondefense discretionary appropriations on the dollar value of the administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's inflation assumptions prove correct, these appropriations will buy fewer real goods and services than the administration anticipates.

TECHNICAL REESTIMATES

Technical reestimates increase the estimated 1988 deficit by $11.6 billion, primarily by raising outlays. CBO's estimated spending for Medicare, which assumes a continuation of recent growth rates, exceeds the administration's figure by $5 billion. CBO's estimates for Medicaid and income security programs are $3.3 billion higher than the administration's.

CBO also believes that the administration's proposals for restructuring foreign military sales debt, recapitalizing the Federal Savings and Loan Insurance Corporation, and selling Amtrak assets, for which the budget includes a total of more than $3 billion in savings, would do little to reduce 1988 outlays. Technical reestimates of revenues add another $1.4 billion to the estimated 1988 deficit.

In the 1989 to 1992 period, the differences in the assumed growth of Medicare, Medicaid and income security programs continue to raise the outlay figures, but technical reestimates also add to revenues by growing amounts. Principal among these differences are different assumptions about how taxpayers will respond to the Tax Reform Act of 1986. CBO assumes that taxpayers will be less successful than does the administration in finding alternative ways to reduce their taxable incomes.

In 1992, technical estimating differences add $16.8 billion to revenues, increase outlays by $10.2 billion, and reduce the estimated deficit by $6.5 billion.

Mr. Chairman, the rest of my prepared testimony discusses the administration's budget policies. With your permission, I would just submit that for the record and be pleased to take your questions now.

Chairman STENNIS. All right. Without objection, your request will be granted and that part of your testimony will be inserted at the proper page.

[The statement of Rudolph Penner follows:]

PREPARED STATEMENT

Rudolph G. Penner
Director
Congressional Budget Office

Mr. Chairman, at the request of this Committee, the Congressional Budget Office (CBO) has prepared an analysis of the President's budgetary proposals for 1988. Copies of our report have been distributed to Members, and I am pleased to have the opportunity this morning to summarize its findings.

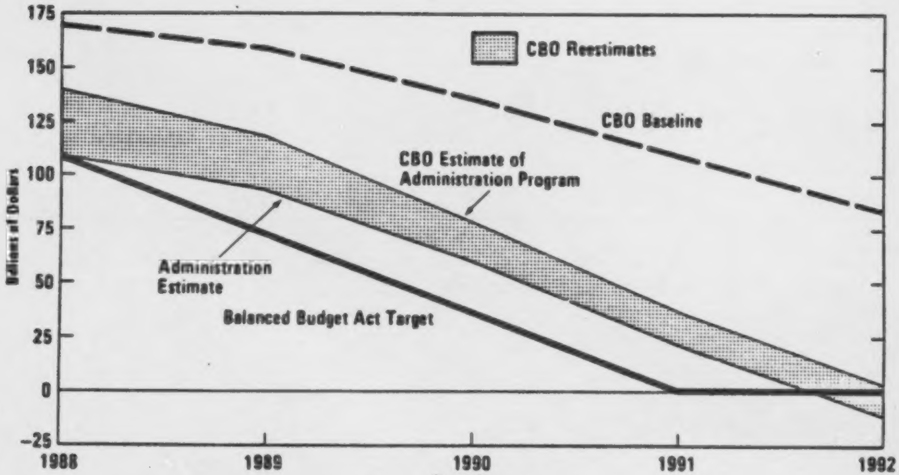
CBO analyzes the Administration's budget in terms of changes from its baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic and technical estimating assumptions and methods. The differences between the baseline projections and the CBO estimate of the budget measure the effects of the Administration's proposed policy changes. Appendix A of our report further describes the baseline projections, which update those published last month in CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1988-1992.*

CBO estimates that the federal deficit under Administration policies would be $134.4 billion in 1988, $117.1 billion in 1989, and $1.2 billion in 1992. These figures are noticeably higher than the Administration's own deficit estimates--$107.8 billion in 1988, $92.8 billion in 1989, and a surplus of $12.3 billion in 1992. CBO's estimate for 1988 represents a reduction of

$36.1 billion below its baseline but is still $26.4 billion above the $108 billion target established in the Balanced Budget Act (see Figure 1 and Table 1).

CBO's reestimate for 1988 is slightly below the low end of the range of our preliminary analysis of the President's budget that we made a month ago. At that time, we estimated that the President's budgetary policies would produce a deficit within the range of $135 billion to $140 billion. Our new estimate of $134.4 billion can be attributed almost entirely to the Administration's plan not to provide advance deficiency payments on 1988 crops during fiscal year 1988.

Figure 1.
Federal Deficit Projections and Targets



SOURCE: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

CBO's estimates of the deficit exceed the Administration's estimates by $3.0 billion in 1987, $26.6 billion in 1988, and declining amounts in later years. Table 2 divides the CBO reestimates of the Administration's budget into those resulting from different economic assumptions and those resulting from technical factors. Most of the reestimates are economic.

TABLE 1. THE BUDGET OUTLOOK UNDER THE ADMINISTRATION'S POLICIES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues						
Administration Estimate	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
CBO Estimate	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Outlays						
Administration Estimate	1,015.6	1,024.3	1,069.0	1,107.7	1,144.4	1,178.9
CBO Estimate	1,010.4	1,039.8	1,086.2	1,136.7	1,182.6	1,231.9
Deficit (-) or Surplus						
Administration Estimate	-173.2	-107.8	-92.8	-59.5	-21.3	12.3
CBO Estimate	-176.2	-134.4	-117.1	-77.9	-35.7	-1.2
Balanced Budget Act Targets	-144.0	-108.0	-72.0	-36.0	0	0

SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

Effects of Economic Assumptions

Although the differences between CBO and Administration economic assumptions are relatively small, they affect the budget estimates substantially. CBO's economic assumptions increase the estimated deficit by $4.2 billion in 1987, $15.0 billion in 1988, and $20.0 billion in 1992.

TABLE 2. CBO REESTIMATES OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Deficit, President's Budget	173.2	107.8	92.8	59.5	21.3	-12.3a/
CBO Reestimates						
Economic						
Revenues	-3.9	-9.7	-9.8	-3.0	8.1	22.6
Outlays	0.3	5.3	11.2	19.0	30.1	42.7
Deficit	4.2	15.0	21.0	22.0	22.0	20.0
Technical						
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Deficit	-1.2	11.6	3.3	-3.6	-7.6	-6.5
Total Reestimates	3.0	26.6	24.4	18.4	14.4	13.5
Deficit, President's Budget as Estimated by CBO	176.2	134.4	117.1	77.9	35.7	1.2

SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.
a. Surplus.

As shown in Table 3 and discussed in Chapter II, CBO assumes consistently lower real economic growth, higher interest rates, and faster inflation than does the Administration. The first two factors tend to increase the estimated deficits, while the third tends to lower them (see Table 4). Lower real economic growth holds down tax receipts, while increasing outlays for unemployment insurance and related programs. CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1987 to $86 billion in 1992. Higher interest rates increase debt service costs by a negligible amount in 1987, $3 billion in 1988, and $18 billion in 1992.

Faster inflation increases most revenue sources (by increasing taxable incomes and consumption) but only raises some outlay categories (primarily indexed benefit programs). It therefore reduces the estimated deficits--by

TABLE 3. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1987-1992 (By calendar year)

Economic Variable	Actual 1986	1987	1988	1989	1990	1991	1992
Nominal GNP (billions of dollars)							
Administration	4,208	4,493	4,816	5,165	5,524	5,879	6,214
CBO	4,208	4,469	4,779	5,124	5,503	5,888	6,288
Real GNP (percent change)							
Administration	2.5	3.1	3.5	3.6	3.6	3.5	3.4
CBO	2.5	2.8	3.0	3.0	3.1	2.7	2.5
Consumer Price Index a/ (percent change)							
Administration	1.6	3.0	3.6	3.6	3.2	2.8	2.2
CBO	1.6	3.5	4.3	4.3	4.3	4.3	4.3
GNP Deflator (percent change)							
Administration	2.7	3.3	3.5	3.5	3.2	2.8	2.3
CBO	2.7	3.2	3.8	4.1	4.2	4.2	4.2
Three-Month Treasury Bill Rate (percent)							
Administration	6.0	5.4	5.0	5.3	4.7	4.2	3.6
CBO	6.0	5.6	5.7	5.6	5.5	5.3	5.2
Ten-Year Government Bond Rate (percent)							
Adminstration	7.7	6.7	6.6	6.1	5.5	5.0	4.5
CBO	7.7	7.2	7.2	6.6	6.2	5.9	5.6
Civilian Unemployment Rate (percent)							
Administration b/	6.9	6.7	6.3	6.0	5.8	5.6	5.5
CBO	7.0	6.6	6.5	6.3	6.1	6.0	6.0

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: Percent change is for calendar-year averages.

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force including armed forces residing in the United States, while CBO's is for the civilian labor force excluding armed forces. In recent years, the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

$3 billion in 1987, $8 billion in 1988, and $84 billion in 1992. CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar value of the Administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's inflation assumptions prove correct, these appropriations will buy fewer real goods and services than the Administration anticipates.

Effects of Technical Assumptions

Technical reestimates increase the estimated 1988 deficit by $11.6 billion--primarily by raising outlays. CBO's estimated spending for Medicare, which assumes a continuation of recent growth rates, exceeds the Administration figure by $5.0 billion (see Table 5). CBO's estimates for Medicaid and income security programs are $3.3 billion higher than the Administration's. CBO also believes that the Administration's proposals for restructuring foreign military

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Lower Real Economic Growth	7	20	33	41	60	86
Higher Inflation	-3	-8	-16	-28	-51	-84
Higher Interest Rates	a/	3	5	8	13	18
Total Economic Reestimates	4	15	21	22	22	20

SOURCE: Congressional Budget Office.
NOTE: The figures include the changes in debt service costs caused by different borrowing.
a. Less than $0.5 billion.

sales debt, recapitalizing the Federal Savings and Loan Insurance Corporation, and selling Amtrak assets--for which the budget includes a total of more than $3 billion in savings--would do little to reduce 1988 outlays. Technical reestimates of revenues add another $1.4 billion to the estimated 1988 deficit.

In the 1989-1992 period, the differences in the assumed growth of Medicare, Medicaid, and income security programs continue to raise the outlay figures, but technical reestimates also add to revenues by growing amounts. Principal among these differences are different assumptions about how taxpayers will respond to the Tax Reform Act of 1986. CBO assumes that taxpayers will be less successful than does the Administration in finding alternative ways to reduce their taxable incomes. In 1992, technical estimating differences add $16.8 billion to revenues, increase outlays by $10.2

TABLE 5. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays						
Medicare	1.8	5.0	4.5	5.6	6.5	7.7
Medicaid	0.5	1.6	1.5	1.3	1.0	0.5
Income security	-0.8	1.7	2.9	2.8	4.3	5.8
FMS debt restructuring a/	0.2	1.1	-0.9	-0.9	-0.9	-0.8
Deposit insurance	-1.8	1.0	1.9	1.3	0.2	0.9
Sale of Amtrak assets	0	1.0	0	0	0	0
Net interest a/	-2.1	-1.4	-3.0	-3.1	-4.8	-2.3
Other a/	3.3	-0.1	0.9	-2.9	-1.7	1.5
Subtotal, Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Total Technical Reestimates	-1.2	11.6	3.3	-3.6	-7.6	-6.5

SOURCE: Congressional Budget Office.

a. Intragovernmental transactions that are offset elsewhere in the budget have been removed.

billion, and reduce the estimated deficit by $6.5 billion. Chapters III, IV, and V of our report describe CBO's reestimates of the Administration's budget in more detail.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Administration's budget proposals would reduce the 1988 deficit to $134.4 billion--$36.1 billion below the baseline level of $170.6 billion. By 1992, the budget would be roughly in balance. Over the 1988-1992 period, the Administration's proposals would reduce the deficit by nearly $300 billion (see Table 6).

The Administration is requesting an increase in real defense appropriations of about 3 percent in 1988 and 2 percent a year thereafter (on the basis of CBO's assumed rates of inflation). Proposed appropriations for procurement are lower than the 1987 amounts, while those for operation and maintenance and for research and development are higher. The higher appropriations sought by the Administration would increase defense outlays by $7.8 billion in 1988 and $71.6 billion over the 1988-1992 period compared with the CBO baseline, which assumes no real growth in defense spending.

To allow for this growth in defense while reducing the deficit, the Administration proposes cuts in nondefense spending and increases in revenues totaling $43.9 billion in 1988 and $370.5 billion over five years. Revenue increases account for $36.0 billion, or only 10 percent, of the five-year deficit reduction. Of this amount, $14.4 billion would result from adding over 10,000 positions to the Internal Revenue Service (IRS) examination and en-

TABLE 6. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billion of dollars

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline Deficit	170.6	164.4	136.8	109.5	84.0	
Defense Increases	7.8	9.2	14.0	17.5	23.1	71.6
Deficit Reductions						
Revenue increases	-5.0	-7.1	-7.7	-8.0	-8.2	-36.0
Outlay reductions						
Financial transactions	-6.6	-2.7	0.3	2.6	5.6	-0.7
Sale of physical assets	-2.8	-1.8	-1.7	-4.2	-2.1	-12.6
Spending delays	-6.5	-0.1	a/	a/	a/	-6.6
User fees and offsetting receipts	-2.7	-4.5	-5.3	-6.3	-7.4	-26.2
Nondefense discretionary programs	-10.7	-20.5	-28.9	-36.4	-43.9	-140.3
Entitlement programs	-8.5	-15.9	-22.3	-27.8	-34.3	-108.8
Debt service savings	-1.2	-4.0	-7.3	-11.3	-15.6	-39.4
Subtotal, reductions	-43.9	-56.5	-72.9	-91.4	-105.9	-370.5
Total Policy Changes	-36.1	-47.3	-58.9	-73.8	-82.8	-298.9
Deficit, President's Budget as Estimated by CBO	134.4	117.1	77.9	35.7	1.2	

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: Totals include Social Security, which is off-budget.

a. Less than $50 million.

forcement staff. (The revenue baseline already includes $17 billion in additional revenues from 1987 to 1992 resulting from the 5,500 new IRS positions added in the 1987 appropriation.) Extending Medicare coverage to all state and local employees would raise an additional $9.3 billion. Other revenue proposals include increasing railroad pension and unemployment insurance contributions, increasing the coal tax that finances the Black Lung program, and eliminating the exemption of state and local governments and most bus companies from highway excise taxes.

The Administration is proposing a number of financial transactions that would reduce recorded outlays in the short run, especially in 1988, though generally at the cost of increased spending later on. These financial transactions account for $6.6 billion, or 15 percent, of the $43.9 billion in deficit reduction in 1988, but add $5.6 billion to the 1992 deficit (not counting debt service savings). Sales of existing loan assets of the Export-Import Bank, Farmers Home Administration, and other agencies produce $5.3 billion in outlay reductions in 1988. In addition, as part of its credit reform proposals (discussed in Chapter VI), the Administration is proposing to sell a number of new loans soon after they are made.

The proposed sale of physical assets--primarily the Naval Petroleum Reserves and the power marketing administrations--reduces outlays by $2.8 billion in 1988 and $12.6 billion over five years. The loss of receipts from the sale of oil and electricity, however, would add to the deficit after 1992.

Although these asset sales provide a temporary reduction in the deficit under current accounting conventions, they squeeze credit markets in almost the same fashion as borrowing by the government. The amount paid for the asset is no more available for private investment than is a like amount loaned to the Treasury.

Proposed delays in spending for Medicare and farm price supports cause a one-time reduction in outlays of $6.5 billion in 1988 but make no lasting contribution to deficit reduction. Delaying the reimbursement of hospitals and doctors for Medicare services reduces 1988 outlays by $2.0 billion. Not making advance deficiency payments to farmers, though done in 1987 and three out of the past four years, lowers 1988 outlays by $4.5 billion compared with the CBO baseline.

The Administration is proposing to increase a number of charges and fees that are recorded in the budget as offsets to outlays rather than as tax revenues. Increased premiums for Supplementary Medical Insurance (Part B of Medicare) account for $16.8 billion of the $26.2 billion to be raised through such user fees over the next five years. The Administration is also proposing to charge more for Federal Housing Administration and Veterans Administration home mortgage insurance, for pension benefit guarantees, and for use of the national parks and forests, and to impose fees for Coast Guard services and meat and poultry inspection.

The foregoing proposals to raise revenues, sell physical and financial assets, delay payments, and increase charges for services constitute a little over 20 percent of the Administration's five-year deficit reduction total. Debt service savings contribute another 10 percent of the savings. The bulk of the deficit reduction, however, is achieved through cutbacks in nondefense discretionary and entitlement programs.

Proposed cuts in nondefense discretionary spending total $140.3 billion over the 1988-1992 period. Among the largest proposed reductions are Farmers Home Administration direct loans, excluding asset sales ($16.3 billion), transportation programs ($15.4 billion), assistance for college students ($13.9 billion), civilian agency pay raises ($14.0 billion), energy supply and conservation ($13.9 billion), natural resources and environment ($12.1 billion), elementary and secondary education ($11.1 billion), Public Health Service programs ($10.7 billion), and housing assistance ($8.5 billion). Similar reductions were proposed in last year's budget, but not enacted. Increases are proposed for international affairs, science and space, and the Internal Revenue Service.

Proposed reductions in Medicare and Medicaid would reduce outlays by $56.7 billion--half of the five-year savings in entitlement programs. Reductions in Commodity Credit Corporation (CCC) direct loans and income support payments to farmers would save another $20.7 billion. Federal employee retirement and health benefits would be cut by $10.5 billion, child nutrition and food stamps by $7.1 billion, and guaranteed student loans by $6.6 billion. With the exception of CCC, most of these proposals were also advanced but rejected last year.

INTRODUCTION OF SENATOR HATFIELD

Chairman STENNIS. I want to call on Senator Hatfield for his fine work in the past and thank him for that now, and we have great expectations of his contribution this year as something that the Senator is familiar with from many different angles. We thank him for coming this morning, and we want you to proceed in your own way and take such time as you may wish.

Senator HATFIELD. Thank you, Mr. Chairman. Thank you very much, Mr. Chairman.

First I would like to wish you well, Dr. Penner, in your new assignment or your new career step. We have found you very cooperative. You certainly performed your task here under difficult circumstances in a most professional way. I am going to miss you.

Dr. PENNER. Thank you, Senator.

CBO RESPONSIBILITIES TO APPROPRIATIONS COMMITTEES

Senator HATFIELD. Dr. Penner, the Congressional Budget Act has charged you very specifically and your office to perform your duties and serve all congressional committees in an impartial fashion with the Appropriations Committee and the Budget Committee being your chief clients.

In recent years, as you recall, both the Appropriations Committee of the Senate and of the House have reinforced this view with report language accompanying the legislative appropriations bills.

We have admonished you in those reports to adhere to impartiality and serve the needs and requirements of this committee as faithfully as any other committee. In large part, I believe you have done that.

But, Dr. Penner, I am very troubled by your latest current level scorekeeping reports submitted to the Chairman of the Senate Budget Committee 2 days ago. I have a copy of that document here that you have addressed to the Honorable Lawton Chiles, Chairman of the Committee on the Budget dated February 17, 1987 under your signature. I would turn to the last page of that particular report to the Chairman of the Budget Committee.

You have calculated in this report, as I understand it, an estimate of current level based on specific instructions from the Senate Budget Committee. You have included that in footnote a, where you said "included at request of Senate Budget Committee."

Now, by practice, and correct me if I am wrong, inclusion of programs in the category of entitlement authority and other mandatory items requiring further appropriation action has been a matter of an agreement, of common agreement amongst the staffs of the Senate Appropriations and the Senate Budget committees, the House Appropriations and the House Budget Committee, and your office.

I understand that in this instance, a possible later requirement for disaster relief was included at the insistence of the Senate Budget Committee, as you noted in your report. It is my understanding that this item was included over the opposition of your staff, the opposition of the Appropriations staff, the opposition of the House Appropriations Committee staff, and the opposition of the House Budget Committee staff.

ABANDONMENT OF CBO IMPARTIALITY

My question, then, comes: Has the CBO abandoned its statutory impartiality and decided to accept the requests of one client, namely, the Senate Budget Committee.

Let me remind you that this is not an entitlement, has never been an entitlement, and yet you display it here in this report to the Senate Budget Committee, at their request, for the reason that the Senate Budget Committee majority staff may not feel that this is adequately funded.

I might say that I am a full supporter of this program. In fact, Senator Bradley and I are the chief sponsors of a larger, more adequate, comprehensive program that we are introducing in this session of Congress. But what troubles me is this Byzantine scorekeeping that has been too often engaged in by the Budget Committee and the CBO and others involved in scorekeeping. If this precedent holds, then it would simply follow, it seems to me, that if one of your clients, whether it is the Budget Committee or some other committee, does not feel a program is adequately funded as a discretionary program, that then we will merely request the CBO to characterize the program as a possible later requirement for the purpose of calculating current levels of funding.

Now, if this becomes a precedent, I think we make a farce out of any of our budget keeping, scorekeeping programs that we are trying to enforce here. Would you care to comment and correct any of my observations that may be in error?

Dr. Penner. I think basically in your opening statement, sir, you were correct to point out that, usually, the process works very well and very congenially, and we generally reach agreement on these matters amongst all of the staffs of the interested parties.

However, when we do not, our interpretation of the law is that in case of a disagreement over scorekeeping rules, the law appoints the Budget Committees as referees on those kinds of matters.

Where there are differences, we do try to point them out, as I did in the footnote to that letter.

There have been a number of instances—they're rare, fortunately—but there have been instances in which that letter you are discussing has different numbers in it for the House and the Senate because the two bodies cannot agree on the appropriate approach to a particular issue. But I really believe that in this instance your argument is not with us but with the Budget Committee.

Senator Hatfield. That what?

Dr. Penner. I believe that your argument is not with us, but with the Budget Committee.

ENTITLEMENT/DISCRETIONARY PROGRAMS

Senator HATFIELD. What was the feeling of your staff on the matter of making an entitlement out of a discretionary program?

Dr. PENNER. As you noted, sir, that's the first time it was done, and——

Senator HATFIELD. Yes, first time. Do you think this is a good precedent? Do you think this should be repeated?

DEFINITION OF AN ENTITLEMENT

Dr. PENNER. I think that here we get into the issue of what is an entitlement and what is not an entitlement. This is a very ambiguous question. We range from the purist of entitlements, as with Social Security, through something like Food Stamps, which is what we call an appropriated entitlement though for all practical purposes it is, in fact, an entitlement.

Senator HATFIELD. Is this program going to be treated as an entitlement from now on? Has this program been treated as an entitlement? Henceforth, at least until we take some other specific action, will this now be considered an entitlement?

Dr. PENNER. I think it is up to the Senate as a whole to decide these issues. It is really a choice for you to make, and not for us.

Senator HATFIELD. Is the effect of this that in case of a future supplemental, there will not have to be an offset made so that we will not have to have an objective of budget neutrality or deficit neutrality?

Dr. PENNER. That is my understanding, sir, yes.

Senator HATFIELD. In other words, this is now exempt from any budget neutrality objective or requirement under Gramm-Rudman or under the Budget Act or anything else because we have now declared this a possible later requirement?

Dr. PENNER. That is my judgment, sir. But again, I yield to other interpretations of it.

Senator HATFIELD. Then, Dr. Penner, could we then declare any other discretionary program in this same manner by the request of a committee as an entitlement, moving it from a discretionary that had been a discretionary program for year after year and all of a sudden, we just decide, whatever it may be, the Budget Committee or the Appropriations Committee or any of your other clients would instruct you to declare something that has been a discretionary program an entitlement?

Dr. PENNER. Well, not any of our——

Senator HATFIELD. Could we do that?

Dr. PENNER. Pardon?

Senator HATFIELD. We could do that, could we not?

Dr. PENNER. If the Senate as a whole wants to instruct us to change the categorization.

Senator HATFIELD. Yes, but is the Budget Committee the Senate as a whole?

Dr. PENNER. They are the referees in the first instance, as we interpret the law.

Senator HATFIELD. Then in other words, it is not the Senate as a whole, it is a committee of the Senate that you, then, can and will henceforth, at their request, declare a discretionary program as now an entitlement program?

Dr. PENNER. They are the keeper of the scorekeeping rules as we interpret the Budget Act. Obviously, rules can be changed by law, but they are the keeper.

Senator HATFIELD. Could it conceivably be that the Coast Guard could become an entitlement at, say, the request of the Budget Committee? Would you then declare it an entitlement?

Dr. PENNER. I suppose it could, conceivably, but as I said, there is a whole spectrum of these things, and the Coast Guard is pretty far out.

[Laughter.]

DISASTER RELIEF

Senator HATFIELD. Well, Disaster Relief is. Mind you, now, I was enthusiastic; in fact, as former chairman of this committee, I led the battle to increase Disaster Relief from the administration's zero funding and have been a supporter of that program. I have no problem with the program in terms of the level of funding, and I would support that. In fact, as you know, this committee offset that increase in the supplemental by shifting funds from FEMA and some other programs for maintaining the neutrality, the deficit neutrality.

But I am troubled by the procedure that we see reflected in this scorekeeping. Are you troubled by it? You are on your way out, now. You can be very honest.

[Laughter.]

Dr. PENNER. I really do think that there are a whole number of decisions that are ultimately political, and they are up to the Congress to decide. We give our best technical advice, but we try very hard to stay out of political and ideological disputes.

Senator HATFIELD. Was I correct in saying that your staff did not recommend this action, that our staff and the Appropriations Committee and the House Budget Committee staff and the House Appropriations Staff and the Senate Budget Committee majority staff all recommended against this action?

Dr. PENNER. As far as I know, that is correct, yes, sir.

Senator HATFIELD. I have other questions, but, Mr. Chairman, I want to observe the 5-minute or 7-minute rule, whatever it may be.

Chairman STENNIS. We are strictly enforcing the time now. We have a party here who needs to speak.

Senator CHILES. Mr. Chairman, I have to leave for another hearing, but I would like to just briefly respond to the line of questioning from my good friend from Oregon.

Chairman STENNIS. You may be recognized, then, to proceed. Senator Chiles?

Senator CHILES. Mr. Chairman, I just wanted to say that I respect very much the opinion of my good friend from Oregon and the former Chairman of this Committee, and I think this is an area in which there certainly can be differences of opinion.

The concern, I think, of the fledgling Budget Committee Chairman who now takes over is to try to have truth in sort of budgeting and where we stand under Gramm-Rudman-Hollings and where we stand in regard to when we have reached our totals and when we have reached our targets and for the Congress to understand. You get into these areas as to what is entitlement and what isn't, and there are all kinds of technical arguments.

I guess what the Senator from Florida was looking at was that Disaster Relief is one of those programs that has to be appropriated, as Food Stamps has to be appropriated, but I think that our custom and practice and usage is that we know when that disaster occurs, we are going to appropriate it. We always have, whether that disaster occurs in Oregon or whether it occurs in a freeze in Florida, hurricane in Florida, canker in Florida. In all of those instances, thank goodness, the Congress has responded, and I think they have in these other instances, too.

If you have a program like that, especially then, people can say there are some unused funds in that program, so we can dip into that program and take those funds out and say that we are not using or we are not going over totals, and yet the Senator from Oregon and the Senator from Florida and Iowa know that in any instance that those funds were being used, they would be replenished.

So you are allowing somebody to sort of do indirectly what they could not do directly if they want to increase a program on the floor, and we saw that instance, and just as you had taken some action on the floor earlier before this to show that the totals had been reached and to restrain other supplementals and further spending, or to at least require staff to waive the Budget Act, which is the proper way, if you are going to exceed that. The Senator from Florida had to stand up there before the waiver of the Budget Act in the Homeless Bill because it was something it looked like the Congress wanted to do and the country needed.

But just to try to have people be able to understand, people in the Congress, that we have breached the total or we are going to breach the total was the reason for the action that we have taken.

As I say, everybody sees their duty, I guess, differently, but coming in as the new chairman, I very much kind of want to at least have the Congress entirely be on notice and not have somebody say afterward, "Well, you could have said that we were" or, "Look, we went over and nobody said a thing about it" or, "Nobody did anything about it."

With some of these things like Gramm-Rudman-Hollings, I think people ought to understand what the effect of that law is. Some people might not have voted for it had they understood, might not have said lightly, "I will vote for that," if they knew what its effects are.

But that was what the Senator from Florida wanted to say.

Senator HATFIELD. Would the Senator yield?

Senator CHILES. Yes, I would be happy to.

Senator HATFIELD. I thank the Chairman of the Budget Committee.

DISASTER RELIEF BUDGET

I think the record ought to show the budget included $96 million for Disaster Relief. We appropriated in the Appropriations Committee $120 million. It was obviously our view, and, I think, everyone else's view that it had been underfunded in the resolution because we couldn't anticipate all those.

Senator CHILES. Yes, sir.

FIREFIGHTING BUDGET

Senator HATFIELD. May I ask this question, too? We have a similar situation in the forest budget. In the forest budget, there is a section on forest fire fighting and costs of protecting the forests under that circumstance, that crisis that we cannot program or finance ahead of time to the accurate level. Would that not be, then, more appropriately considered as an entitlement?

Senator CHILES. I am really not sure. I haven't had an opportunity to examine that.

Senator HATFIELD. I would like to submit that to the Budget Committee for consideration, because much like disaster, forest fires are a type of disaster that cannot be programmed or anticipated, and it would seem to me that if we start a precedent here of taking those programs that are difficult to project because of circumstances beyond our control, that maybe we ought to consider all of them as entitlements.

Senator CHILES. I understand, and if you will notice in that Subsection 5 on the last page of that report, we are talking about entitlement authority for the mandatory items requiring further appropriation items. So we already talked about things like retirement pay and the civilian agency pay raise. We already are including items that aren't specifically entitlements because we know that they will be paid.

Senator HATFIELD. Senator Chiles, you know, you and I have been here through various cycles of the Budget/Appropriations Committees' relationships.

Senator CHILES. Yes, sir.

Senator HATFIELD. We have seen them when they were very tense and difficult. I think we have seen them when they have become very cooperative, and I would like to maintain that kind of relationship.

Senator CHILES. I certainly concur with the Senator from Oregon in that regard.

Senator HATFIELD. But I do feel that in a circumstance of this kind, it gives rise to, again, unnecessary tension and rivalry, or whatever you want to call it, between the two committees, and I think when one committee secures this kind of action, especially when there's not been, say, even a discussion at the committee member level, now, at the staff level, I wonder if henceforth we could kind of get some of these things discussed where we get a clear understanding between the members, especially where there is disagreement between the staff.

Senator CHILES. The Senator from Oregon raises a very good point, and I think he is correct.

Senator HATFIELD. I thank the chairman. I pledge him my full cooperation as the new Chairman of the Budget Committee.

Senator CHILES. I thank him. I am going to leave.

Chairman STENNIS. Members of the committee, I am not sure I have an accurate list here of the order in which you came in for questions and who to call on next. We have this important hearing. I am sure that if we work together, we will find time for everyone to have a chance to ask questions, and let's approach it that way. We will keep things going.

The Senator from New York is next on my list. Does anyone have anything they can put in the record by consent?

[No response.]

Chairman STENNIS. All right. That is good. I recognize the Senator from New York and hope you won't take over 10 minutes. But if you have to have it, you have 10 minutes.

Senator D'AMATO. Thank you very much, Mr. Chairman. I, too, would like to commend Mr. Penner for his outstanding service to the Congress in his heading of CBO, and I certainly wish you the best of luck in your new position.

Dr. PENNER. Thank you very much, Senator.

Senator D'AMATO. And in your new endeavors.

OMNIBUS BUDGET RECONCILIATION ACT, 1986

Mr. Penner, I am increasingly disturbed by what I see as a tendency to resort to budgetary gimmickry, which may now have gone beyond just a gimmick stage. I would like to cite to you at least one example.

I have this document here called the Omnibus Budget Reconciliation Act of 1986. On page 388, it says, and I would like to quote from it to you, do you have a copy of that?

Dr. PENNER. I don't.

Senator D'AMATO. Let me give this to you. Would someone bring it down? It is on page 388.

On Page 388, where it talks about the proceeds of user fees for the Customs, it says, "The proceeds of such fees would be deposited in a dedicated account within the General Fund of Treasury and be available subject to authorization and appropriation to offset appropriations to the Customs Service for the cost of commercial services rendered."

Are you familiar with that?

Dr. PENNER. In vague terms, yes, sir.

Senator D'AMATO. Do you see it there?

Take a look at it in specific terms, now. Look at that. That is what I gave you, that little document. Do we understand that? That is the law.

Mr. Penner, I am increasingly disturbed by what I see as a tendency to resort to budgetary gimmickry, which may now have gone beyond just a gimmick stage. I would like to cite to you at least one example.

I have this document here called the Omnibus Budget Reconciliation Act of 1986. On page 388, it says, and I would like to quote from it to you, do you have a copy of that?

Dr. PENNER. Yes.

Senator D'AMATO. Now turn over to page 390. The third paragraph, one, two, three, "All Customs users fees, whether derived from merchandise entries or otherwise, are to be deposited in a dedicated account in the General Fund of the Treasury to be used"—and I am providing the emphasise—"to be used exclusively to reimburse the Customs service appropriation."

Are you aware of whether or not that is being done and how in this, an OMB budget, they have accounted for these approximately $800 million over the next 2 years?

Dr. PENNER. They are in a special dedicated account, sir.

Senator D'AMATO. Really? It is my understanding that OMB is allocating approximately $417 million of new Customs users fees to an account for general revenues rather than directly to the Customs Service account. If that is true, would that be complying with the law as set forth in the budget?

Dr. PENNER. As far as I know, sir, they are in a special fund; they are dedicated; they are earmarked only for the use of the lines and the words you read. I know of no deviation from that. I would be pleased to get more information about it if you wish.

Senator D'AMATO. All right, good. I would deeply appreciate by the end of the day your staff reviewing this as it relates to that $417 million, approximately, which comes to our account. This seems to be applied to budget reduction or placed in the general revenues—as opposed to a dedicated source. Now, that is the information we get. We would like you to look into it.

Dr. PENNER. It may well be that not all of the fund is spent in the same sense that not all of payroll taxes are spent.

Senator D'AMATO. It would seem that this language is rather clear in saying that it must be dedicated to this fund and specifically not set aside or impounded or deferred, which brings me to my second question.

I would like you to look into that.

Dr. PENNER. All right.

Senator D'AMATO. If you read both of those sections, you see that all of these funds are going to be set aside exclusively to reimburse the Customs Service appropriation.

DEFERRALS

I would like you to look into a recent decision with respect to deferral. I understand that the circuit court here in the District of Columbia has ruled in the city of New Haven case that the procedures of deferrals have been held violative of the law. Are you aware of that?

Dr. PENNER. Yes, sir. I am not a lawyer, but as I understand it, that goes back to the Chadha decision which raised considerable doubt about deferrals because of the use of the one-house veto there, and now this court decision makes that more explicit with regard to deferrals than it was before.

Senator D'AMATO. My question is raised because of what I see as a tactic, whereby, instead of asking for a rescission or a deferral, we get the OMB people issuing a comment that they are considering, they are considering the possibility of a deferral or a rescission. They have done that for the months of October, November, December, and January.

AIR INTERDICTION PROGRAM

One of those actions, specifically concerning the air interdiction program, I would call to your attention. On February 6 they sent over a document that says "Operations and maintenance of the air interdiction program. Of the funds made available under this heading by the Omnibus Drug Supplemental Appropriations bill of 1987, Title 2," they say, "$32,099,000 shall be available for obligation only after October 1, 1987," and they are asking for an amendment in the law.

It says, "This language would preserve the option for Congress to use these funds to offset 1988 funding for the Customs Service."

I would like you to give us an interpretation of whether or not they have this authority. They are not asking for a rescission or deferral. They are asking Congress to amend the law, and I will give you that.

Dr. PENNER. Actually, sir, the referee on that sort of matter very explicitly is the GAO. That last questions is probably better answered by them.

Senator D'AMATO. OK. Mr. Chairman, I, again, want to commend Mr. Penner for, I think at least, being the scorekeeper that we can count on with a great deal more reliability than, unfortunately, our own OMB. I certainly would like you to verify that matter as it relates to that account, whether or not, indeed, it meets with the requirement under the law as spelled out by the Budget Reconciliation Act.

Dr. PENNER. We will certainly look at that, sir.

Senator D'AMATO. Thank you, Mr. Chairman.

Chairman STENNIS. Yes, thank you. Members of the committee, I want to raise a question here, now. It takes too long to have gone into it before, but I want to raise it and get an answer to it.

REACHING GRH DEFICIT TARGET

In your personal judgment, is it practical to reach the Gramm-Rudman-Hollings deficit target of $108 billion? I think that is a fair question, and I know you are competent and able to point out these things to us. It would be helpful, quite helpful.

I will repeat that, if I may. In your personal judgment, is it practical to reach the Gramm-Rudman-Hollings deficit target of $108 billion? Can you explain any assumptions that you have involved in your answer?

Dr. PENNER. Well, sir, I think it really depends very much on how you do it. If you look at what happened last year in our recalculation of what happened since the Gramm-Rudman report of August 20, we estimated that the Congress legislatively cut some $32 billion from the deficit, but $11 or more billion of that was a temporary surge in revenue resulting from tax reform; $7 billion was from asset sales; and $4 billion resulted from pushing outlays either forward into 1986 or backward into 1988.

What I am saying is that a very large portion of the $32 billion was the result of actions that have no long-lasting effect on the deficit. If you go about it that way again, using what we might call smoke and mirrors—no problem, you can get to $108 billion.

REAL DEFICIT REDUCTIONS

If, on the other hand, you are talking about real deficit reduction, that now would involve a cut of more than $60 billion. I think that is quite another matter. It could be a considerable shock to the economy.

We have, in the past, had larger shocks. We had a bigger change in fiscal policy going from 1959 to 1960. We had a bigger change going from 1969 to 1970 with the Vietnam surcharge. I am speaking, of course, relative to the size of the economy. Both of those changes were followed by recessions. This change would be lower than those two changes by a considerable margin, but still, we are talking about a very large shock.

Because last year's measures were so temporary in nature, we have suggested a different way to look at the problem in our annual report. This would imply that if you do talk about changing the Gramm-Rudman target, it might also be useful to consider changing the rules under which we count asset sales. Obviously, that is a rather large loophole, now, in the administration of Gramm-Rudman. There are many others, of course, but that is a very obvious one.

I want to be clear: I am not commenting on the wisdom of asset sales here. Some of them may be really excellent policy. There was wide consensus about Conrail, and so on. But what we are suggesting is that when assets are sold, loan assets in particular, they be considered a means of financing the deficit as opposed to a deficit reduction. Because from an economic point of view, when you sell, say, a farmer's home loan to the market, it is very little different than selling a Treasury bond. It absorbs savings, has about the same economic effects, and therefore we don't think it should be counted as deficit reduction. That isn't to say it is a bad idea, let me emphasize that.

Chairman STENNIS. All right. I think my time is about up.

Senator Reid, that brings us to you.

Senator REID. Thank you very much, Mr. Chairman. Thank you.

Before asking my first question this morning, I want to take this opportunity to thank you for testifying and also to recognize your outstanding performance as Director of the Congressional Budget Office.

Dr. PENNER. Thank you.

Senator REID. As a Senator and as a House Member, we looked forward to your testimony. I want to commend you on your adherence to the requirement of producing accurate, nonpartisan budget projections, and I think that this has been praised by both the Senate and the House as being scholarly and nonconfrontational.

The Congress and others who are, I believe, committed to credible Federal budget procedures will be the worse for your loss. Once again, I thank you for your public service and wish you well in your new endeavors.

SMOKE AND MIRRORS BUDGET PROCEDURE

You used the term just a minute or two ago that I had in my first question. Myself and many of my colleagues are concerned about what we call the smoke and mirrors budget procedure. In particular, I will refer now—there are certainly other procedures—but I am referring now to the practice of including trust funds in the unified budget figures.

Would you explain the rationale for including such funds?

Dr. PENNER. Sir, the main goal of the unified budget that we use is, as I would interpret it, giving us cash flow figures that tell us as a bottom line how much of a deficit we have to finance either on the country's capital markets or by some other means. The unified budget isn't perfect in that regard, but it is pretty good, I think, generally.

To get that bottom line, you really do have to include the trust funds in it. For example, we now have the Social Security trust fund running a surplus. To the extent that it is running a surplus, the Treasury can convey bonds to it that will not go out into the street and absorb savings. It is this concept that we are most interested in.

Budgets can be constructed to serve all sorts of purposes other than the one that I just described, and those budgets might need different definitions. But to really understand the effects of the Federal Government on the economy, you have to consider what is going on in the trust funds as well as in the other parts of the budget.

Senator REID. Mr. Penner, from our standpoint and people we represent, however, if they paid a tax, for example, on the highway trust fund for road construction and for other purposes, isn't that what the money should be used for? By law, that is a requirement, isn't it?

Dr. PENNER. I think you are hitting the same sort of point that Senator D'Amato hit a little earlier: What is the law with regard to those things? I think it is a political understanding that an earmarked tax should obviously be used for what it is earmarked for, but the very fact that we have a trust fund means that you make some allowances for surpluses some years and deficits other years in storing up the money.

But I think you are right. In the long run, the understanding is that the earmarked tax will be used for the earmarked purposes. We have departed from that, of course, often. I mean, the Congress often decides to change the understanding, so that, for example, the moneys in the highway trust fund can be usable for mass transit or whatever the Congress wishes them to be usable for.

TRUST FUNDS INCLUDED IN UNIFIED BUDGET

Senator Reid. Give us your opinion before you go on to other fields of endeavor. Do you maintain, then, that the law should remain—well, I shouldn't say law—the practice should remain now as it is, that these trust funds be included or not included in the unified budget?

Dr. Penner. I believe that they should be included.

Senator Reid. Tuesday, James Miller, in an editorial appearing in the Wall Street Journal, attempted to redefine the word "tax." What is your definition of the word tax, and would you explain to me the difference between the words tax, a revenue and a user fee? [Laughter.]

DEFINITION OF A TAX

Dr. Penner. I am not sure I am an expert, but to me, a tax is a fee paid. It is compulsory, first of all.

Senator Reid. Even a user fee?

Dr. Penner. Pardon?

Senator Reid. Even a user fee would be in that definition?

Dr. Penner. No, I think the definition of a user fee is more of a problem, but let me get to the definition of a tax first, which is a compulsory payment for which there is not a clear benefit.

I think at the other end of the spectrum is what I will call a pure user fee, for example, something like a fee to get into the national parks or a fee to use some other Government service. In essence, you have a choice of going into the park or not, at whatever the stated price is.

In between are a lot of things that are sometimes called user fees and sometimes called taxes. For example, the gasoline tax. You just mentioned the highway trust fund. I think one gets into a somewhat ambiguous area there.

You have a choice whether or not to buy gasoline, but most people have to buy it to some degree. The roads that a driver uses are financed in different proportions by that trust fund, so the linkage between use and payment begins to get obscured and ambiguous.

I frankly don't care much what you call it, whether you call it a tax or a user fee.

Senator Reid. I have one last question, Mr. Chairman. On page 3 of the information that has been given to us prepared by you, page 2, figure 1.

Dr. Penner. Yes, sir?

Senator REID. In your statement on page 2 there is a graph. The way I understand it, using the figure we have from the administration, that would be a $108 billion deficit.

Dr. PENNER. That is correct.

Senator REID. But your office's interpretation, using even the base figures of the President, you would come out with a deficit of $138 billion or thereabouts; is that right?

Dr. PENNER. For fiscal year 1988, $134 billion, sir.

Senator REID. OK. Using the projections of the Congressional Budget Office, you come out with about, what is that, $171 billion or something?

Dr. PENNER. Yes, sir. Well, let me clarify a point here. The $171 billion is what you would get if you did nothing to any law and this committee appropriated all of the programs under its jurisdiction at a level that would just make up for inflation. What we are suggesting is that the President has proposed real spending cuts and revenue increases in his budget that would bring that down from the $171 billion to our estimate of $134 billion.

Senator REID. The question, then, is that there is a real difference between your projections and that of the administration, using even their figures.

Dr. PENNER. Well, not really using their figures. What we do is take their policy.

Senator REID. OK, I used the wrong term then; using their policies.

Dr. PENNER. That is correct. There is about a $26 billion difference in the final deficit.

Senator REID. How do we come to that difference?

DIFFERENCES IN ESTIMATES

Dr. PENNER. I think the main point is that the budget is very sensitive to one's economic forecast. Very obviously, revenues depend on the amount of economic activity; unemployment insurance depends on how many are unemployed and so on. That goes right through the budget in a great variety of ways.

So a considerable part of the difference is the result of that difference in economics. Indeed, about $15 billion of the difference is in economics. The rest is the result of some disagreement about how much certain programs would cost. One of the big disagreements, as I point out, is over estimates of Medicare costs, for example.

Senator REID. Thank you very much, Mr. Chairman.

Chairman STENNIS. Yes, sir. Thank you, Senator.

Senator Grassley? Senator Grassley, you are next, sir. We recognize you.

Senator GRASSLEY. Thank you, Mr. Chairman.

Dr. Penner, I, too, join my colleagues in wishing you well in your new endeavor and am always sorry that as qualified people like you leave that we, quite frankly, don't have a better chance of getting better acquainted. But I guess that is the way life is in Washington, because we are all so busy.

GRH TARGETS

But I wanted to visit with you about the targets that come under Gramm-Rudman and, of course, we all know that we have locked ourselves into the targets in the hope for a balanced budget by 1991. Now, of course, we are faced already early this year with rumors floating around Congress that we are going to have to abandon those targets later this year.

I think the feeling is that these targets are very unrealistic, but it was only a year ago that they were not considered unrealistic. They were, at that time, considerable reasonable goals as a long-term progression toward eliminating the deficit, and the fact is that instead of being faced with $36 billion in cuts this year, we are facing something like $60 billion of changes.

So I would like to have you explain why things are so different than we expected, than they were just a short time ago.

Dr. PENNER. Sir, it goes to Senator Reid's point about what makes these numbers move around so. I think that the grave difficulty that we face in the ordinary budget process—and this difficulty has been greatly intensified by the Gramm-Rudman law—is that the process and that law, in particular, depend heavily on economic forecasts and estimates.

Senator GRASSLEY. You are saying they are unrealistic, as well?

Dr. PENNER. Pardon?

Senator GRASSLEY. You are saying, then, that they are unrealistic, too?

Dr. PENNER. The targets now? I didn't want to say that. I am trying to make a larger point.

Senator GRASSLEY. OK.

EFFECTS OF FORECASTING ERRORS

Dr. PENNER. My point is that perhaps the process is unrealistic in its expectation of what we economists and budget technicians can deliver in terms of precision of estimates. Now that we have outlays over $1 trillion, a 1-percent change in our estimate, which I regard as trivial as a forecaster, amounts to $10 billion.

Such a trivial error creates a massive political problem for this committee. I mean, this committee certainly knows how hard it is to take the budget of the United States and cut $10 billion. So something that is an annoyance to an economist becomes a matter of almost life and death in terms of the politics of the issue.

That, I think, is a flaw in our whole set of procedures. I have given a lot of thought throughout my career as to how that flaw might be corrected. I even used to write upon it before I came to CBO. I thought I had some suggestions, but after working in this environment I have decided all of those were pretty silly, and I haven't come up with anything better.

So I think the basic problem is that these numbers jump very much. We had a fairly unusual jump between August of last year and this current forecast. Only a relatively small part of that was economics. I think our economic forecast was pretty good, but we started to get reports from all sorts of agencies saying they were going to spend a lot more than they had estimated in their previous reports. In particular, some big changes came from the FDIC and the FSLIC, agencies that face enormous uncertainties in how much they will have to spend to bail out the banks.

So there are an enormous number of random variables in this process, and that is why the numbers jump around as much as they do.

BASELINE DEFICIT PROJECTIONS

Senator Grassley. If I can't get you to say that the targets are unrealistic, could it be that the baseline deficit projections have been unrealistic?

Dr. Penner. I wanted to comment on the other point separately. Let me comment on the issue of whether the targets are unrealistic.

As I said to the chairman, I think it depends on how you do it. If you cut the deficit with as many temporary measures as you did last year, then it is not so hard. To review the figures again, $32 billion of deficit reduction, but only $6 billion, $7 billion was in long-term deficit reduction.

If you had that ratio this year, there would be no problem. We think, however, that perhaps the rule should be tightened with regard to asset sales. Then you would have a very difficult problem.

Senator Grassley. I would like to suggest that not only CBO, but maybe in too many institutions of Government there is too much what I refer to as institutional optimism.

DEFICIT PROJECTION

That leads me, then, to this point and question: I guess I would start out by saying that it was last September that we were all giving speeches that we want to refer back to that kind of says, "Well, I told you so," and that is not my main point here. But I did suggest, as I indicated in my first question to you, that these deficit estimates weren't very realistic; that they were underestimated; that the targets would be very difficult to achieve; and I don't suggest I am the only one that said that.

I suggested that our deficit projection—at that time we were talking about $154 billion—be much greater, and I think we all agree now that it is going to be. I used as my rationale the historical pattern of systematic bias within the Congressional Budget Office's estimating of those deficits.

I think it is unrealistic estimating, in my opinion, that contributes to the pressure today to abandon deficit targets. I hope we don't abandon those. So my question is: What has the Congressional Budget Office done or, let me ask, what has it learned with all these problems? I mean, you suggested that what you had written prior to coming to your present job, you even had to come to some different conclusions dealing with it as an administrator.

But what have you learned at the agency to help Congress deal with these optimistic estimates that have made the budget targets so difficult to reach, or what has CBO itself done to correct maybe some of its own bias in estimating?

BIAS IN ESTIMATING

Dr. PENNER. Sir, we have partially corrected that bias, because of your personal prodding. I will show you, sir. We have reviewed the record in a number of different ways, most recently in an appendix to our report. I refer you to page 142, and then subsequently to 145, where we talk about the reasons for the errors.

This examines our short-run projections, and you are absolutely right that in recent years our forecasts have been too optimistic as a general rule.

That was not true in the 1970's, by the way. When CBO started off it tended to be pessimistic all the time. We have been looking very carefully at the question whether there is some kind of inherent optimistic bias in our procedures. I think we have discovered some sources of bias, not of much importance, with regard to the short run.

With regard to the long run, we have a different situation. I think in the late 1970's there was a tendency in projecting the economy out to project what we hoped would happen with regard to unemployment, inflation rates and so on. We projected on the basis of our goals.

I think my predecessor started to change that in the early 1980's. I have tried to change it some more since I have been there, to base our projections more on our historical experience—not on what we hope will happen, but on what history suggests might happen.

Even there, I have to admit, we have been too optimistic. It turns out that the economy's productivity record in the last few years has been dismal compared with past history. All of us had hoped for better, and so we were too optimistic.

This year, we ratcheted our projections down again to try and get these optimistic biases out of them. We looked harder at what we could expect in terms of economic growth in the future. It did make us more pessimistic.

I don't know if we are right now; maybe now we are too pessimistic. Obviously, it is very difficult to make forecasts and projections. You can't even forecast the past any more because our statistical agencies keep revising the historical numbers on us.

Senator GRASSLEY. The problem is, if you have a small mistake long term, it is really a doggone big mistake.

Dr. PENNER. Absolutely.

Senator GRASSLEY. I thought maybe there was a disagreement between you and I.

Dr. PENNER. I don't think there is any disagreement whatsoever, Senator.

Senator GRASSLEY. Could I ask you how you are coming? You mentioned that I had been doing some prodding in this area, and section 2905——

Chairman STENNIS. Gentlemen, I hate to interrupt you, but your time has run over.

Senator GRASSLEY. OK, Mr. Chairman. I will quit, but would it be possible for me, if I would go to another committee and would come back here before 12:00, would I be able to finish some questioning?

Chairman STENNIS. There is some chance. We will certainly try to cooperate with you on the problem. I think we can find a way.

That brings us to you, Senator Mikulski.

Senator MIKULSKI. Thank you. If Senator Grassley would actually even yield some of his time to me, I am going to the White House for the lifting of the sanctions.

Senator GRASSLEY. I am done. I am done.

Senator MIKULSKI. Thank you.

Senator GRASSLEY. I am going to come back, I thought I made that clear. I don't want to take any more than my correct amount of time. I just wanted to try to finish.

Chairman STENNIS. We will try to accommodate you.

Senator MIKULSKI. I don't get many invitations to the White House.

[Laughter.]

Senator MIKULSKI. Thank you, Mr. Chairman.

Dr. Penner, I, too, want to voice my appreciation for the nonpartisan way in which you have approached this and the excellent materials that you continue to provide the Congress, and we wish you well in your private sector endeavors.

Dr. PENNER. Thank you.

Senator MIKULSKI. We hope our economy does as well as you are about to do.

TRUST FUNDS

I have two questions, one, back to the trust fund issue and then the other related to the budget process. As you recall, Congress, in the early 1980s, bit the bullet in the funding of the Social Security system to make sure that we would strengthen the trust fund. Now, because of this rather, rather strong medicine we all took, particularly the seniors themselves, the trust fund is in good shape. That is the good news.

The bad news, though, is that the Social Security trust fund is being counted again towards the budget issue. My question is: If we took out the Social Security trust fund in your calculations, what would—which was the old Lyndon Johnson approach. I think he was the first to put the Social Security trust fund in the budget.

Dr. PENNER. Yes.

Senator MIKULSKI. Is that what you meant as the Vietnam surcharge?

Dr. PENNER. No. I was referring to a special tax increase during the Vietnam War. There is a difference.

Senator **Mikulski**. We had a couple of other excise taxes in there.

Could you give me a picture, if you would, and I think the committee, particularly, of the Social Security trust fund, if it were removed from the budget calculations?

SOCIAL SECURITY TRUST FUND

Dr. **Penner**. Let me point out that right now it is in a bit of an ambiguous position. The law declares it off budget for purposes of the budget process, so that means, for example, it cannot be subjected to a reconciliation bill.

However, the Gramm-Rudman law makes it count for the purposes of these targets. We, in our documents, differentiate it because the law puts it "off budget." The actual surplus in the trust fund, going back to fiscal 1986, was $17 billion, and $19 billion in 1987. $36 billion is our estimate for 1988. By 1992, it reaches the massive amount of $75 billion, and it will continue to rise after that for awhile.

Of course, in the distant future when the baby boomers of the 1940's and 1950's start to retire, the massive surplus will disappear with lightning speed. I am talking about 20 and 30 years from now.

But you are right; with the 1983 amendments, we did, at least for the next 50 years, make the income and the outflow balance.

DEADLINES ON BUDGET PROCESS

Senator **Mikulski**. Let me pick up on what Senator Grassley was saying about the budget process. We all feel very strapped by the deadlines. You submit the budget; the Budget Committee begins to work its will. The authorizing committees wait for the budget targets to be set. Appropriations, of course, has the benchmarks it needs to meet, and all this process is happening allegedly simultaneously, but in a very uneven way.

What happens, then, we end up with these continuing resolutions that no one exactly knows what is in them. It leaves us in a very uncomfortable position in terms of really sound fiscal policy.

TWO-YEAR BUDGETING

My question to you, and now that you have been head of the CBO office, would you recommend any changes in the process, as someone, to make us be able to do our job appropriately? Would you recommend a 2-year budget process or any others that we could deal with ourselves in an efficient, responsible way, exercising prudent analysis and rather keen oversight?

Dr. **Penner**. The first point I would like to make as strongly as I can is that I don't think the process itself is the problem, that it is the reason for our problems in adhering to schedules and so on. I think, rather, the problem is that since the late 1970s we have, in our society, been debating a rather massive change in government priorities, and I think any system is under strain when the priorities are being changed as radically as they have been. You don't see many instances in our history where that has happened. I mean, it has really been a watershed along a very large number of dimensions.

Having said that, I obviously don't think the process is perfect. You mentioned 2-year budgeting. I would not want to promise that it would help a great deal, but I think the Committee for Economic Development made an interesting suggestion a number of years ago to separate out various bureaus and offices of the government where things don't change much year-to-year, where the economics doesn't play much of a role. I am thinking of the Bureau of Engraving, or of CBO for that matter, which go along at about the same level every year. For those agencies, I should think that 2-year budgeting could save you some time.

I think that one has to be careful when one gets into certain other areas that are impacted a lot by economic events, because if you had a 2-year budget you would very often have to reopen it.

So I wouldn't want to suggest that such a change would be a huge improvement, but it offers room for marginal improvement. It would be an interesting experiment. I have not heard yet how this committee intends to handle the Defense appropriation this year, but for the first time the President has submitted a 2-year budget in the Defense Department. That raises an interesting opportunity to experiment, I suppose, although Defense is so complex and fast-changing that I think it would be harder to do 2-year budgeting there than in a lot of other areas.

Senator MIKULSKI. Thank you for your insights, and again, we wish you well.

Dr. PENNER. Thank you.

Senator HATFIELD. Mr. Chairman, I wonder if I could interrupt and follow along on the line of questioning of the Senator from Maryland for just one question.

Chairman STENNIS. Yes.

Senator HATFIELD. If I could.

Chairman STENNIS. I am sure.

ACTIONS TAKEN TO CONTROL BUDGET

Senator HATFIELD. Dr. Penner, I guess longevity sometimes creates either optimism or cynicism or maybe something in between. But some of us have been here long enough to walk through the Rose Garden agreement, to remember Roth-Kemp, to remember the Budget Act of 1974, the Harry Byrd amendment and, more recently, the Gramm-Rudman-Hollings attempt to control the deficit.

They all had some direct implications for that objective. I am sorry Senator Grassley is not here, because he expressed surprise, and I know that many others have, that these targets have not been met. I don't think it is out of cynicism, but perhaps out of realism, that some of us who did not support Gramm-Rudman or any of the other gimmickry that has been used to deal with the deficit really believe that these targets will be met. We are never going to reach them when we restrict ourselves in dealing with this very complex issue to such a very narrow segment of the issue, namely, when we refuse to face up to only partially one-half side of the coin.

What I mean by that is the spending and the revenue are the two sides of the coin, to oversimplify the problem for just an illustration. We refuse to deal with the revenue side in a realistic way. The new tax bill is going to have a bit of revenue enhancement, but it has not considered the revenue swings that may occur here and during the out years.

So in effect, it has not been geared to the deficit as much as some of us would like to have seen it adhering to the deficit. From the spending side, we have had an administration that has refused to deal with the spending side in a realistic way, as well, by largely exempting the entitlements, which is the fastest growing part of the spending side. We have had a distorted focus upon discretionary spending only, as Gramm-Rudman-Hollings did, and only on a portion of that, because the military part of that discretionary spending keeps going up. So that trend line that has been occurring over the last number of years has not contributed to solving the deficit.

So when you come down to that small portion of the spending side of the coin of this problem, exempting the entitlements and, in effect, exempting the military, we are down to about $170 billion baseline out of a $1 trillion budget.

Dr. Penner, realistically, as long as we restrict our actions to that small baseline, can we ever balance the budget? Over simplified, but time factor being what it is, I wanted to get to the basic point.

Dr. PENNER. You have done the arithmetic correctly.The portion you refer to is now actually less than the whole deficit; it has been restricted relative to our incomes.

In 1986, for example, that portion took 4.1 percent of the GNP. It goes as high as 5.8 percent in 1980, but it was 4.2 percent in 1962. So we sort of walked up the Great Society mountain, as it were, and walked back down, relative to our incomes. In short, you are right. I have no disagreement with what you have said about the arithmetic of the situation.

Senator HATFIELD. I thank the Senator from North Dakota and the Chairman for allowing me to intrude here, but it seems to me, really, nobody should be surprised about these targets and the missing of these targets year after year after year. We can blame it on inaccurate forecasting and a lot of other things, but really, it is the whole concept of how we are approaching the problem, it seems to me, that is faulty.

Chairman STENNIS. Very fine comments. It was a good question and a good answer.

All right, Senator Burdick.

FARM CREDIT SYSTEM

Senator BURDICK. Thank you, Mr. Chairman. The CBO baseline contains no provision for a Federal infusion of money to the farm credit system. As you know, Congress enacted legislation at the end of 1985 which made it possible for the Department of Treasury to purchase issues from the capital corporation. However, before this could happen, Congress must appropriate the money.

Recent indications are that the farm credit system is continuing to show losses and that a Federal infusion of money will be required this year.

What is your anticipation? What is the administration going to do in this area, and will we need this Federal infusion before we go broke?

Dr. PENNER. I would rather not try to speculate about the administration's plans since I don't work for them. But in terms of the basic situation you are referring to, there have been estimates on the street that as much as $15 billion might be needed. We have not come up with a precise estimate.

Our estimate of the possibilities would be lower than that. We have a range going all the way from $2 billion to $10 billion right now, which is quite a range, but we hope to sharpen that up in the future.

Senator BURDICK. You are aware that in the last 2 years, we have showed some pretty heavy losses?

Dr. PENNER. That is correct, sir.

Senator BURDICK. If those losses continue in the same range and the same amount, the farm credit system will be out of money.

Dr. PENNER. One of the more dramatic numbers I have here is that the asset side of the system's balance sheet contracted by nearly $8 billion during the first 9 months of 1986.

Senator BURDICK. Don't we have to get some money into this system?

Dr. PENNER. I think the system is in jeopardy. There is no doubt about that.

Senator BURDICK. Thank you very much.

Chairman STENNIS. Are you finished?

Senator BURDICK. By the way, Mr. Chairman, could I submit to Dr. Penner some other questions for the record?

Chairman STENNIS. Yes. Without objection, further questions will be placed in the record for answers.

DEFICIT OPTIONS

Chairman STENNIS. Doctor, I have a few questions here. Senator Grassley is coming in a few minutes. I have something. According to an article which appeared in yesterday's edition of the Washington Post, opinion appears to be building on Capitol Hill that the fiscal year 1988 deficit target of $108 billion should be revised upward.

In order to meet the $108 billion target, Congress is faced with three choices: raising taxes, sharply reducing the Defense budget or altering the deficit target of $108 billion. Comment, if you will, on what are the advantages and disadvantages of each of these options? I am not advocating that this be done, but I am asking for comment. I just want a discussion, mind you, with you in your very fine capacity.

Dr. PENNER. I wouldn't advocate any particular one of those solutions above the other, in terms of the advantages and disadvantages. Again, I keep going back to this point: That it is important to restrict our discussion to real deficit reduction as opposed to temporary deficit reduction.

If that is what you are talking about, then as I suggested before, the disadvantage of adhering religiously to the $108 billion target is that it means a substantial shock to the economy, less than we have applied at other times in history, but still a substantial shock, which creates certain risks.

The advantage, of course, is that the capital markets would be very impressed if you adhered rigorously to that definition and did it in real ways. I think you would probably see some reduction in interest rates, because I don't think that the capital markets of the world really expect the United States to adhere to that target.

If it did, and did it in real ways, the psychological benefit would be considerable and would offset some of the negative shock that I am talking about.

With regard to the question whether deficit reduction should be in the form of taxes or spending, I think that goes to the core of the debate over national priorities that I was discussing with Senator Mikulski. That is fundamentally much more an ideological discussion than it is an economic discussion.

There are, of course, bad economic ways of raising taxes or cutting spending, and there are good ways of doing it if you choose, but your choice really involves the issue of what the government should and should not be doing, and who should pay for it. That is not a technical problem; that is a political problem.

Chairman STENNIS. All right. We find here constantly before us that not only the deficit, but the trade balance and the shifting trends continue to go against a strong economy. There is an on-going debate among the economic community regarding whether there is any direct cause-and-effect relationship between the U.S. trade deficit, which stands today at approximately $170 billion, and the U.S. budget deficit, which stands today at approximately $176 billion.

Please give us your thoughts as to what effect, if any, you think one has upon the other.

BUDGET DEFICIT AND TRADE DEFICIT

Dr. PENNER. As you say, Mr. Chairman, there is a great deal of dispute within the economic community about the relationship, and even more about the mechanisms through which such a relationship might occur.

Our own analysis at the CBO is based on the assumption that there is a very strong relationship, indeed. The most powerful mechanism at work is that our deficits raise the interest rate here, making the United States generally a more attractive place to invest, so people buy our securities, and they need dollars to do that. That greatly raises the value of the dollar and puts our international traders at a competitive disadvantage and results in the trade deficit.

Perhaps a much simpler way of putting the whole issue is that if foreigners are using their dollars to finance our budget deficit directly and indirectly, they can't afford to buy our goods. So we think, indeed, there is a very strong relationship.

Chairman STENNIS. What?

Dr. PENNER. A very strong relationship exists between the two deficits.

Chairman STENNIS. Yes. To me, it is just a layman's viewpoint. I don't know everything about it, but I know the trade balance, free trade and all like that, it has been a big part of our economic picture in the South. A fellow that maybe didn't get beyond the eighth grade, he has some kind of idea about that trade. He knows that that is a big part of what keeps things going.

All right, Senator Grassley. I am glad you found time to get back. You will proceed in your own way, and I have other questions.

Senator GRASSLEY. Thank you.

As I said, I wanted to take up where we left off, and we were talking about the impact of bias, whether or not it has had a short-term impact or a long-term impact. I guess this chart, which I know that you have seen charts like this before that project what the deficit is supposed to be, but I don't think there is any better illustration of that a short-term judgment can have a long-term impact, that there is any better. I think this is evidence of institutional bias that is built into our system that you admitted; it is just a question of whether or not it has got long-term bad, long-term or short-term. .

Getting back to the question, what, within CBO, is being done to overcome the bias? You said it was recognized. Some adjustments were made, but is this an internal mechanism that has been changed?

BIAS IN FORECASTING

Dr. PENNER. Again, sir, let me differentiate. When we forecast, we of course have to depend on past history for our basic information. That is, all we know is past history. The fact of the matter is that the country's recent economic performance has been low by historical standards or at least compared with the rest of the post-war period.

I think there has been a general tendency among all economists, private or public, to be a little bit on the optimistic side about our prospects for long-run growth. We all hope for better in terms of things like productivity. As the evidence has come in, we have had to lower our expectations.

We were wrong. I am not sure I would say it was a bias, but basically, we made a mistake about the prospects for U.S. economic growth. As I said, we have been responding to that, and we have been lowering our projections.

As to whether there is a set of internal biases, I think there are some. I don't want to exaggerate their importance, though. They probably extend from the very bottom to the very top of the organization. We start with the numbers we get from agencies. Individual agencies don't want to make their programs look like they cost a lot or else the Congress might cut them, so if there is a mistake to be made, they probably depress them a little bit.

There is constant pressure on the part of advocates of programs that we are costing to make them seem to have a lower cost. We try to resist that, but it is there. Not many people want us to make them look as though they cost more.

I also have to say that whenever CBO does make a pessimistic assumption, it is very unlikely to be used by the Congress. The Congress tends to take our assumptions and make them more optimistic by altering them in one way or another.

So there is a bias. I think it runs through the whole system, and we keep trying to fight against it. The way we fight against it is to be very open about our mistakes. We have, in many documents, examined the record of the budget resolutions. We publish all our forecast errors of the past and compare them to those of private forecasters. Actually, we do extremely well, I think, compared with private forecasters.

But still, there was a tendency to err on the optimistic side in the early 1980's, not in the 1970's as I said. In the 1970's, there was an institutional bias toward pessimism.

Senator GRASSLEY. I guess I would suggest in looking at the chart, it would seem like we are losing the war. But you know, I surely don't imply anything sinister in the fact that we have institutional biases. I wouldn't say that Congress exercises the guts it ought to when it looks at the realities of a free market economy. We don't do that because we ought to project that sometime, there is going to be recession and downturn, and we ought to be ready for it, but we aren't ever ready for it.

SECTION 2905 OF DEFICIT REDUCTION ACT OF 1984

But along the line of trying to correct the bias, I guess as I left, I referred to Section 2905 of the Deficit Reduction Act of 1984, passed in June of 1984, an amendment that I got adopted which would require CBO to determine the reliability of assumptions underlying our budget estimates and also including the bias. The purpose of the law was to help alleviate the problem of underestimating deficits, to deal with precisely what we are talking about here, a situation we are still faced with, and particularly, today, I guess in light of the fact that there is some talk on the Hill, which I hope doesn't materialize, of abandoning the targets.

A report was required from CBO on June the 1st of 1985 pursuant to the law. Was that deadline met, and what is the status of the report?

Dr. PENNER. I am embarrassed to say, Senator, it wasn't met. We have been working on it. It got shunted around by Gramm-Rudman duties and other things. We regard the materials on pages 141 through 145 of our annual report as a sort of first installment of the kind of materials that you requested. But we have not completed all the work we would like to do on it yet.

Senator GRASSLEY. That would probably refer to just A-1, I mean A-1 of the three requirements under A?

Dr. PENNER. Yes, that is correct. With regard to the others, to take a more intensive look at Defense and another agency, we have completed our work in draft form on Defense. We have not yet gotten an analysis of another agency.

Senator GRASSLEY. Okay. In regard to part B of section 2905, it is to require a joint analysis by CBO and the General Accounting Office to examine bias.

Dr. PENNER. I'm sorry.

Senator GRASSLEY. You mentioned Defense.

Dr. PENNER. I misunderstood you. I forgot that was part B. Yes, that is what I was referring to.

STATUS OF CBO REPORT

Senator GRASSLEY. GAO has finished its report, about a year ago. Could you give me the status of CBO's work?

Dr. PENNER. Yes, that is what I mistakenly referred to with regard to the Defense Department.

Senator GRASSLEY. When would you expect that they would be completed?

Dr. PENNER. It should be completed within a couple of months.

Senator GRASSLEY. That is my last question, but I think that we may not agree on exactly the impact of bias, and I may emphasize it more than you do, and those are honest differences of opinion. But we do agree on some bias and, hopefully, the ability to overcome it. I think that what we have in 2905 will be very valuable to Congress, and, I guess, very helpful to us in realistically getting those targets reset for 1991. Really, what we have to depend upon is better assumptions from CBO and, of course, then we have to be honest with ourselves and with you and not fudge on them when we get the professional advice from you.

Dr. PENNER. I should say, Senator, that in response to our concern about optimistic bias, as I suggested before you left, we have done an enormous amount of study of what one might reasonably expect the economy to produce over the next few years. That is the subject of our chapter on economic growth. More importantly, perhaps, we have lowered our estimates of long-run economic growth in the future.

I don't want to rule out the possibility that we may even have gone too far in trying to counter the sort of thing you are worried about.

Senator GRASSLEY. Are you suggesting, then, that we get back to a point where we were in 1970 of being too pessimistic?

Dr. PENNER. I am not saying we are doing that, but I would not want you to interpret our latest long-run estimates as being necessarily too optimistic, because, as we have in the past, we have really tried to construct them so that the errors are 50–50 on each side. We have got that rate of growth down to 2½ percent at the end of the projection period, which is certainly much lower than we and most other economists were thinking of in the past.

I should also point out that, by accident, we did all our work and made our projections, and then compared them with key private projections. It was not our intent, but as it turns out our projections of growth through 1992 are almost exactly at the average of what private people are saying, though there is a big difference of opinion among them.

Senator GRASSLEY. Mr. Chairman, I am done asking questions. Thank you.

Chairman STENNIS. Yes, all right. Thank you very much, Senator. Thank you very much.

The Senator from New York, Mr. D'Amato, has certain questions he has submitted to the Chairman with the request that they be inserted in the record and asks for a response to be printed and included in the responses. That is done without objection.

Chairman STENNIS. Do you have something further that you would like to say? You certainly are free to say it.

Dr. PENNER. No, sir, Mr. Chairman, except to say that I have really enjoyed my relationship with this committee, and in difficult times I think our work together has been about as easy and cooperative as possible given the circumstances.

Chairman STENNIS. I expect if there was some way for you to know all the truth it would disclose that you have been and your work has been felt and appreciated here more than you might think or the casual observer might think. You have brought with us a good name, a good reputation in our profession. You enhanced both and made a contribution to these problems, although they are not all solved yet.

Dr. PENNER. Next week, sir.

[Laughter.]

Chairman STENNIS. This is a new world from what things were here when I first came here. I am not registering that as a complaint, but this is just a new world, and I have learned one thing: Do not try to pull it back like it was; it won't go back. Whatever improvements you might find, it will be somewhere else, not going back to the old ways.

It is a trying time this, as you will recall, the 200th Anniversary of the adoption of the Constitution, on which we have done more than survive. We have grown and prospered and had our share of happiness and development; leadership has been great.

But I think we are in a rather distressing time now. That doesn't mean I am saying we are not going to get out, but it is very difficult, the idea of a budget of the size that we have now and other signs along the way beyond our expectations. We have just got to try harder and work harder and make some personal sacrifice. But we can certainly find a way. We have no excuse for not doing it.

We have been pretty good at meeting our crises before, and we can, and I think we shall do it again. Certainly, it is still in a jumble here now, and there will be no quick nor easy answer, but as a whole, our Congress has got potential strength and accurate strength, too, and I have no pressuring doubt that we will come through. I think it is going to take more of a man of your capacity and experience and training and learning to come and help out.

I am not happy to see you leave. You have made a real contribution here and, I think, a lasting contribution.

Dr. PENNER. Thank you, sir. Any time I can be of help in the future, I will be pleased to do that.

Chairman STENNIS. Thank you. Thank you very much. I am sure I speak for all the Members of this group here, this committee, when I express those sentiments and wish you well and those that have been with you, helping you by whatever name they are called, staffer or otherwise. We are indebted to them, too, and appreciate what they have done.

SUBMITTED QUESTIONS

All right, is there any other matter now to come before the committee? I have certain questions here, it is only about three, for myself, and I ask unanimous consent that those be inserted together with those of other Members in the record at this point. I hear no objection. It will be so ordered.

[The following questions were not asked at the hearing, but were submitted to the Office for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR STENNIS

Question: According to today's report by the Congressional Budget Office, Congress will miss the current fiscal year (1987) deficit target of $144 billion by $32 billion and must cut $63 billion from current "baseline" spending levels to reach the $108 billion deficit target for fiscal year 1988 imposed by the Gramm-Rudman-Hollings Balanced Budget Act. Your office has also estimated that a failure to close this $63 billion gap could result in a sequestration order which would result in a 14 percent reduction in 1988 budget resources for defense and a 20 percent cut in spending for domestic programs. What are the implications for our national economy and the welfare of our citizens if such cuts should result?

Answer: A $63 billion reduction in spending resulting from sequestration would amount to roughly 1½ percent of GNP. In the past, deficit reductions of this magnitude or larger have generally been followed by recessions, such as those experienced in 1960 and 1970. Under our current system of floating exchange rates, however, such contractionary effects should be reduced by offsetting improvements in the trade balance. Large reductions in spending for defense and domestic programs could detract from our military capabilities and endanger the achievement of some domestic objectives.

Question: The President's proposed budget contains a variety of deficit reduction proposals, which include among others for fiscal year 1988:

(a) $4.2 billion in net deficit savings from loan asset sales from such agencies as the Farmers Home Administration, the Rural Electrification Administration, and others;

(b) $5.2 billion in savings from "privatization" efforts, such as the sale of Naval petroleum facilities and various power administrations; and

(c) $3.2 billion increase in user fees for such government services as Veterans Administration home loans, National Park Service recreation, and others.

Will these and other such proposals also address a long-term continuation toward deficit reduction or are they more in the nature of a one-time-only reduction in the 1988 deficit?

Answer: The proposed sales of physical and financial assets would reduce outlays in the short run, under current accounting conventions, though generally at the cost of increased spending later on. In contrast, the proposed increases in user fees would make a long-run contribution to deficit reduction.

Question: As we all know, President Reagan is currently embarked on a "competitiveness" campaign to bolster our nation's ability to compete in business over the long-run. One of the major elements of his campaign is the improvement of our country's educational standards. However, in his proposed budget, the President provides that over the next five years:

(a) spending for elementary and secondary education would be reduced by $11 billion; and

(b) spending for higher education and universities would be reduced by $22 billion.

Although I recognize that you are an economist and not an educator, Dr. Penner, I am interested in your views as to whether our nation's educational standards can be improved while at the same time such substantial reductions are being proposed for our educational programs.

Answer: In theory, educational standards--and educational outputs--could be improved even in the face of reductions as large as those you mention. The amount of money spent on education does not bear a consistent relationship to the outputs produced, for some schools use their resources more efficiently than others. Thus, just as an increase in spending need not bring about real improvements in educational outputs, a reduction in spending would not necessarily reduce the quality of education.

In practice, however, reductions in federal aid could hinder some efforts to improve education. Many of the educational initiatives now under discussion or recently undertaken will indeed cost money, and reductions in federal aid would make it that much more difficult for educational institutions to raise the needed funds.

It is also important to bear in mind that the federal contribution to education is relatively small, especially in elementary and secondary education. For example, in the 1984-1985 school year, federal aid constituted about 6.5 percent of total revenues for public elementary and secondary education. At the college level, federal spending for student aid equalled about 10 percent of general institutional revenues; the amount of federally supported aid available to pay college costs, including loan principal that will eventually be repaid by students, amounted to roughly 15 percent of general institutional revenues. Even a large reduction in federal aid therefore represents, on average, a relatively small decrease in total resources available. In postsecondary education, though, substantial reductions in federal aid could have larger ramifications if students were prevented from attending college or forced to choose less expensive institutions.

Federal aid to education is often targeted to students with specific needs, and those students--and the institutions serving them--are affected by federal cuts much more severely than the average figures suggest. For example, substantial reductions in federal support for financial aid for postsecondary students could make it more difficult for students, especially low-income students, to pay college costs and could result in fewer students attending school or could limit their choices in selecting institutions.

Question: Dr. Penner, using the CBO economic forecast for fuel, has the Department of Defense requested sufficient funds for fuel purchases in 1988 and 1989?

Answer: For both fiscal years 1988 and 1989, CBO forecasts lower crude oil prices than the Administration. If the CBO forecast proves accurate, DoD will have sufficient funds to carry out its planned fuel purchases. But CBO's fiscal year 1987 projection of approximately $15 per barrel for the average refiner's acquisition price of crude oil was based upon futures prices that were current at the time of the forecast (December 1986). In January, as a result of an agreement by the OPEC countries limiting their production of oil, the crude price rose above $18 per barrel. If oil prices remain at this level through 1988 and 1989, DoD will not have enough funds to complete its planned purchases.

Question: Dr. Penner, what is your view of the currency exchange rates used in the DoD budget request? Are these rates realistic considering the recent fall of the dollar against the mark and the yen?

Answer: Neither CBO nor DoD makes an attempt at forecasting exchange rates. The budget request for the Operations and Maintenance accounts that are subject to gains or losses from exchange rate fluctuations has been based upon exchange rates that were current in the month of December. Since then, the dollar has weakened against most currencies. If the request for 1988 were to be repriced using rates as of the middle of February, these Operations and Maintenance accounts would be underfunded by about $400 million.

Question: The CBO estimate of the GNP deflator for 1988 and beyond is somewhat higher than the Administration's estimate. What is the impact on the cost of defense purchases if Congress were to use the CBO estimate of the GNP deflator?

Answer: If CBO's estimate of defense purchases inflation (which is very close to its GNP deflator) was substituted for the rate used by the Administration, the same level of purchases would require approximately $175 million more in budget authority than was included in the President's request for 1988.

Question: What is the status of inflation for defense purchases that were funded in FY 1987 and earlier? Does the latest inflation data (actual and revised) suggest that Congress provided too much or too little funds for inflation for these years?

Answer: With the drastic slowing of inflation since 1982, the Congress has been concerned about possible "inflation dividends" accruing to the DoD. Overfunding for inflation occurred when inflation forecasts used in providing appropriations for the DoD were higher than the actual rates. Last year, the appropriations committees rescinded approximately $2.2 billion from 1983 through 1986 appropriations based upon updated inflation experience and forecasts. The final 1987 appropriations were also reduced (by $2.6 billion) to reflect the changes in economic assumptions between the February budget submission and the Administration's Midsession Budget. If the 1987 appropriations were repriced at currently forecasted rates of inflation, about $600 million might be similarly available for rescission or reprogramming. For earlier years, it is impossible to determine how much, if any, funding in excess of inflation has been provided. This is because no precise method of accounting for inflation through the budget process exists.

Question: Dr. Penner, in answer to a question by Senator Mikulski, you indicated that doing a two-year budget for defense might be difficult because defense is so complex and the requirements are fast changing. Can you expand on these comments, highlighting difficulties that we might face if Congress did attempt to do a two-year budget for defense.

Answer: A two-year budget for defense would pose problems for several categories of defense systems. Some systems experience technical or production problems; the budget level for the second year of a two-year budget will depend on the success in solving those problems during the first year. It is also possible that military requirements that seemed fixed during the first year of a two-year budget could change before the second; this year's shifts in Navy plans for aircraft carriers and aircraft are one example.

In addition, the overall level of defense resources could change, which might alter the dollars available for many defense programs. During the last two years, the level of defense resources has been reduced by an average of over $30 billion dollars a year or more than 10 percent below the Administration's proposed level, largely because of overall budget limits. These limits often change as a result of shifts in the economy that are difficult to foresee two years in advance. Had a two-year budget been in effect in recent years, these cuts would have required revisiting many defense programs during their second year. I do not want to suggest that there is no advantage to a two-year budget. The stability it could offer to some defense programs, coupled with the discipline it might impose on the Department of Defense by requiring the DoD to examine budget plans in detail for two years at a time, are potentially important. Even if problems prohibit the implementation of a two-year budget for all defense programs, the Congress could possibly achieve many of these benefits by focusing its two-year budgeting efforts on programs that are clearly stable in terms of technology and requirements.

Question: There continues to be a dispute in projected outlays for defense spending (050, 051, and the defense bill). Can you explain why OMB states that your baseline for FY 1988 is understated by $3 billion in outlays?

Answer: First, let me describe our defense baseline. The CBO baseline is a projection of actual appropriations for 1987 that holds the defense budget constant in real terms. In other words, the baseline projection for 1988 contains the same mix and level of defense appropriations as 1987, but includes full adjustment for expected price changes.

OMB states that our baseline is too low because it feels that real growth in total defense budget authority is necessary and that the mix of programs within any given total should reflect proportionately more funding for accounts that spend out quickly.

Question:	Can you estimate what outlays would be for 050, 051 and the defense bill if the President's defense budget request were reduced to 2% real growth, 1% real growth and zero real growth, maintaining the mix of programs recommended by the President, and by reducing the request using the mix of previous appropriations bills compared to the previous requests.
Answer:	The table below shows the budget authority and outlays for zero, 1 percent, and 2 percent real growth in the defense budget. These real growth totals are based upon the President's pay raise proposals and CBO forecasts for defense purchases inflation. The top half of the table shows the outlays that would result if the mix of programs requested by the President were maintained. The bottom half of the table shows the outlays that would result if budget authority cuts from the President's request were made in the same proportion as reductions in previous appropriation bills.

PROJECTIONS FOR NATIONAL DEFENSE BUDGET AUTHORITY AND OUTLAYS FOR FISCAL YEAR 1988 (In billions of dollars)

	Budget Authority	Outlays
Three Real Growth Options Maintaining the Mix of Programs Requested by the President:		
0% Real Growth		
Function 050 Total	303.0	293.1
Function 051 Total	294.6	284.9
Defense Bill	284.4	276.7
1% Real Growth		
Function 050 Total	306.0	294.9
Function 051 Total	297.5	286.6
Defense Bill	287.4	278.5
2% Real Growth		
Function 050 Total	309.1	296.6
Function 051 Total	300.4	288.3
Defense Bill	290.4	280.2
Three Real Growth Options with Reductions in the President's Program by the Average of Past Appropriations Reductions:		
0% Real Growth		
Function 050 Total	303.0	294.4
Function 051 Total	294.6	286.1
Defense Bill	284.1	277.8
1% Real Growth		
Function 050 Total	306.0	295.7
Function 051 Total	297.5	287.4
Defense Bill	287.1	279.3
2% Real Growth		
Function 050 Total	309.1	297.0
Function 051 Total	300.4	288.7
Defense Bill	290.3	280.6

Question: Explain the effect of prior-year financing adjustments on the CBO baseline, specifically addressing the effect of sections 9046, 9047, and 9094 of the FY 1987 Defense Appropriations Act.

Discuss any baseline adjustment for each section and explain the rationale.

Answer: The CBO baseline for the defense budget is a projection of actual appropriations for 1987 that holds the level and mix of programs constant in real terms. CBO projects outlays in defense accounts based on their historical spending patterns. These patterns affect not only the outlays from new budget authority, but also the outlay estimates for unexpended balances from past appropriations.

The sections you refer to affected the budget authority and outlay projections differently. Section 9046 lowered the unexpended balances in certain procurement and RDT&E accounts by rescinding about $5.3 billion--so consequently we have a lower outlay estimate than if the funds remained available. Rather than assume that $5 billion of rescissions would occur each year, this section did not affect our projection of budget authority.

Section 9047 transferred about $5.4 billion in available balances from the revolving funds to the operation and maintenance (O&M) accounts; this transfer had the effect of lowering our outlay estimate for the revolving funds and raising it for the O&M accounts. This section did not affect our projection of budget authority because it did not affect 1987 budget authority—the base for our projections.

Section 9094 provided new budget authority to pay the costs of federal pay raises authorized for 1987. Our projection for budget authority in 1988 includes the full-year cost of this provision. Our baseline estimates outlays based on the historical spending rates for pay in the military personnel accounts and for civilian pay in general.

Question: Dr. Penner, in your comments this morning you said that the 1988 deficit target of $108 billion could readily be met through budgetary "smoke and mirrors," but that meeting the target with real spending cuts could have a "shock" on the economy.

Please enumerate the specific budget items you had in mind when you spoke of "smoke and mirrors?"

Answer: Many proposals to reduce the federal deficit would do little or nothing to reduce the federal government's presence in the credit markets, which is the ultimate goal of deficit reduction. Sales of financial and physical assets, such as Farmers Home Administration loans or the Naval Petroleum Reserves, squeeze credit markets in almost the same fashion as borrowing by the government. Slowing down spending--for example, by delaying military pay from September 30 to October 1, 1987—has a negligible effect on the amount and timing of federal borrowing. Actions of this sort may be characterized as "smoke and mirrors."

Question: Please elaborate on the effects of the economic "shock" that could occur if the $108 billion target were met through real spending cuts?

Answer: There are wide differences of views regarding the economic impact of such a fiscal policy shock. Some analysts maintain that it would have a very depressing impact on output and employment. Others argue that it would not have much effect at all. My personal view is that reducing the deficit to $108 billion without any "smoke or mirrors" would slow growth somewhat, but the difference is well within the range of uncertainty surrounding the CBO economic forecast. Our outlook for moderate growth is a middle-of-the-road forecast which assumes that sequestration will be avoided. This could be achieved through Congressional action involving $10 billion of asset sales and equal amounts of tax and spending changes that would reduce the remaining deficit to $118 billion--the maximum permitted under the Balanced Budget Act. In the event that sequestration is not avoided, the resulting cuts in spending would be greater by $10 billion to $20 billion, depending on the volume of asset sales.

Baseline Amounts for Drug Initiative

Question: Title II of the Continuing Resolution for FY 1987 provided supplemental appropriations of $1,666,251,000 plus, "such sums as may be necessary" for the Department of Justice "Assets forfeiture fund". Please provide the Committee, by account, with the amounts you project for this initiative in your Baseline in FY 1988 and future years.

Answer: The attached table shows approximate amounts included in our baseline projections as a result of enactment of Title II. They are approximate because the appropriations for the drug initiative are mostly portions of larger accounts, and thus are not separately identified in the baseline. These projections were developed by increasing the supplemental amounts provided in 1987 by the aggregate account inflators in each year.

APPROXIMATE AMOUNTS IN BASELINE FOR DRUG PROGRAMS AUTHORIZED BY THE ANTI DRUG ABUSE ACT OF 1986 (P.L. 99-570) AND FUNDED BY TITLE II OF THE CONTINUING RESOLUTION (P.L. 99-500 AND P.L. 99-591, OMNIBUS DRUG SUPPLEMENTAL APPROPRIATIONS ACT OF 1987) (By fiscal year, in millions of dollars)

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
SPECIFIC APPROPRIATIONS							
15-1100-01-751	Drug Enforcement Administration						
	Budget Authority	60	65	66	68	70	71
	Outlays	51	62	65	68	69	71
15-0322-01-752	United States Attorneys						
	Budget Authority	31	33	34	35	36	37
	Outlays	27	33	34	35	36	36
15-0324-01-752	United States Marshals						
	Budget Authority	17	18	19	19	20	20
	Outlays	16	18	19	19	20	20
15-1003-01-753	Federal Prison Construction						
	Budget Authority	97	101	106	110	115	120
	Outlays	19	57	96	105	109	114
15-1060-01-753	Federal Prison System						
	Budget Authority	28	30	31	32	32	33
	Outlays	26	30	31	32	32	33
10-0923-01-752	Defender Services						
	Budget Authority	18	19	20	20	21	22
	Outlays	11	16	19	20	21	21

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
10-0925-01-752	Fees and Expenses of Jurors & Comm.						
	Budget Authority	8	8	8	8	9	9
	Outlays	7	8	8	8	9	9
15-1020-01-752	Support of U.S. Prisoners						
	Budget Authority	5	5	5	6	6	6
	Outlays	3	5	5	6	6	6
15-0200-01-751	Voice Radios -- FBI						
	Budget Authority	2	2	2	2	2	2
	Outlays	2	2	2	2	2	2
20-1408-01-751	Voice Radios -- Secret Service						
	Budget Authority	5	5	5	6	6	6
	Outlays	4	5	5	6	6	6
15-0401-01-754	Office of Justice Programs-Drug Grants						
	Budget Authority	225	235	246	257	269	281
	Outlays	62	190	245	247	259	271
10-0920-01-752	U.S. Courts Drug Abuse Program						
	Budget Authority	12	13	13	14	14	14
	Outlays	11	13	13	14	14	14
11-0212-01-551	White House Conference on Drug Abuse						
	Budget Authority	5	---	---	---	---	---
	Outlays	4	1	---	---	---	---

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
11-1022-01-151	International Narcotics Control						
	Budget Authority	53	55	57	60	62	65
	Outlays	19	38	48	55	58	60
11-1021-01-151	AID - Drug Education						
	Budget Authority	3	3	3	3	4	4
	Outlays	a/	1	2	2	3	3
67-0201-01-154	USIA - Drug Education						
	Budget Authority	2	2	2	2	2	2
	Outlays	2	2	2	2	2	2
17-1506-01-051	Navy, Aircraft Procurement						
	Budget Authority	183	194	202	211	220	229
	Outlays	16	82	142	177	196	204
57-3080-01-051	Air Force, Other Procurement-Radar						
	Budget Authority	71	74	77	80	84	87
	Outlays	35	53	67	74	79	82
57-3400-01-051	O & M, Air Force - Helicopters						
	Budget Authority	13	13	14	14	14	15
	Outlays	10	13	14	14	14	15
21-2031-01-051	Army Aircraft Procurement - Helicopters						
	Budget Authority	18	19	20	20	21	22
	Outlays	3	10	15	18	19	20

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
17-1804-01-051	O & M, Navy - Coast Guard Personnel						
	Budget Authority	15	16	16	17	17	18
	Outlays	11	15	16	16	17	17
69-0201-01-403	Additional Coast Guard Active Personnel						
	Budget Authority	39	42	43	44	45	47
	Outlays	33	40	43	44	45	46
69-0240-01-403	Acquisition, Construction, & Improvements						
	Budget Authority	89	93	97	101	105	109
	Outlays	9	39	69	86	125	129
75-1361-01-551	ADAMHA Health Services						
	Budget Authority	177	185	195	206	217	227
	Outlays	141	184	193	204	215	225
75-1361-01-552	ADAMHA Health Research						
	Budget Authority	41	43	45	48	50	53
	Outlays	26	38	43	47	49	52
36-0160-01-703	Veterans Medical Care (Transfer)						
	Budget Authority	10	11	12	12	12	12
	Outlays	9	11	11	12	12	12
75-1361-01-552	Drug Abuse Research b/						
	Budget Authority	27	28	30	31	33	35
	Outlays	17	25	29	31	32	34

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
75-1361-01-552	Alcohol Abuse Research b/						
	Budget Authority	3	3	3	3	4	4
	Outlays	2	3	3	3	4	4
75-1361-01-552	Youth Suicide Information/Studies						
	Budget Authority	3	3	3	3	4	4
	Outlays	2	3	3	3	4	4
91-1000-01-501	Special Programs						
	Budget Authority	200	210	222	234	248	261
	Outlays	30	122	208	219	231	244
75-0390-01-551	Indian Health						
	Budget Authority	16	17	18	19	19	20
	Outlays	13	16	18	18	19	20
75-0391-01-551	Indian Health Facilities						
	Budget Authority	6	6	6	6	6	7
	Outlays	1	4	5	6	6	6
14-2301-01-452	Construction						
	Budget Authority	13	13	14	14	15	15
	Outlays	3	10	12	14	14	15
14-2100-01-452	Operation of Indian Programs						
	Budget Authority	10	11	11	11	12	12
	Outlays	8	10	11	11	12	12

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
44-0103-01-506	Action Grants						
	Budget Authority	3	3	3	3	4	4
	Outlays	2	3	3	3	4	4
75-0120-01-609	Gen. Dept. Mngmt.-Info on Drug Abuse						
	Budget Authority	3	3	3	3	3	4
	Outlays	2	3	3	3	3	4
20-0606-01-751	Payments to Government of Puerto Rico						
	Budget Authority	8	---	---	---	---	---
	Outlays	8	---	---	---	---	---
14-1036-01-303	Operation of National Park System, police						
	Budget Authority	1	1	1	1	1	1
	Outlays	1	1	1	1	1	1
75-1361-01-552	Substance Abuse Coverage Study						
	Budget Authority	1	---	---	---	---	---
	Outlays	1	---	---	---	---	---
20-0602-01-751	Customs Service Salaries & Expenses b/						
	Budget Authority	44	48	49	50	51	52
	Outlays	40	47	49	50	51	52
20-0604-01-751	Air Interdiction b/						
	Budget Authority	93	96	100	105	109	114
	Outlays	42	76	98	107	111	116

TREASURY I.D.	ACCOUNT TITLE OR ACTIVITY	1987	1988	1989	1990	1991	1992
20-5693-02-803	Customs Forfeiture Fund b/						
	Budget Authority	10	4	4	4	4	4
	Outlays	10	4	4	4	4	4
SUBTOTAL - Specific Appropriations							
	Budget Authority	1,667	1,730	1,805	1,882	1,966	2,048
	Outlays	739	1,293	1,654	1,786	1,913	1,990
"SUCH SUMS" APPROPRIATIONS							
15-5042-02-751	Justice Assets Forfeiture Fund						
	Budget Authority	14	15	18	22	25	28
	Outlays	5	11	16	19	22	26
BASELINE TOTAL	Budget Authority	1,681	1,745	1,823	1,904	1,991	2,076
	Outlays	744	1,304	1,670	1,805	1,935	2,016

NOTE: Details may not add to totals because of rounding.

a. Less than $500,000.

b. Authorized in the Omnibus Budget Reconciliation Act of 1986 (P.L. 99-509) and also authorized in the Anti-Drug Abuse Act of 1986.

Immigration Reform

Question: The Immigration Reform and Control Act of 1986 (Public Law 99-603) made advance appropriations of $1 billion for each of fiscal years 1988, 1989, and 1990.

How were those funds allocated in your Baseline?

In the President's request?

How does your outlay estimate compare with the OMB estimate?

What funds, if any, were built into your baseline numbers in FY 1987 for this legislation?

Answer: The $1 billion of advance appropriations for fiscal years 1988, 1989, 1990, and 1991 were allocated in CBO's baseline as follows (by fiscal year, in millions of dollars):

	1988	1989	1990	1991	1992
Interim Assistance to States for Legalization (Function 500)	930	732	637	608	--
Supplemental Security Income (SSI) (Function 600)	27	83	103	116	--
Food Stamps (Function 600)	1	4	6	6	--
Medicaid (Function 550)	42	181	254	270	--
TOTAL	1,000	1,000	1,000	1,000	--

In the President's request, the $1 billion of advance appropriations were allocated as follows:

	1988	1989	1990	1991	1992
Interim Assistance to States for Legalization (Function 500)	930	655	744	733	--
Food Stamps (Function 600)	3	14	9	9	--
Medicaid (Function 550)	67	331	247	258	--
TOTAL	1,000	1,000	1,000	1,000	--

The President's budget shows no SSI spending because the Immigration Act's language is unclear as to whether SSI qualifies for the offset to the $1 billion to cover federal costs.

Outlay estimates for interim assistance to states for legalization are:

	1988	1989	1990	1991	1992
CBO	121	595	850	804	537
OMB	300	533	914	990	309

Funds built into CBO's baseline in fiscal year 1987 for the Immigration Reform and Control Act of 1986 are (in millions of dollars):

Medicaid (Function 550)	
Budget Authority	1
Outlays	1
Unemployment Compensation (Function 600)	
Budget Authority	0
Outlays	8
Immigration Legalization (Function 750)	
Budget Authority	149
Outlays	139
Total	
Budget Authority	150
Outlays	148

Effect On Sequester Calculation Of Enacted Exemptions To The Gramm-Rudman-Hollings Amendment

Question: Since the enactment of the Balanced Budget and Emergency Deficit Control Act of 1985, some major accounts have been exempted from the sequester procedure, primarily in last year's reconciliation act and veterans' authorization act.

In your Baseline Report last year you estimated that reductions of $23 billion would require across-the-board reductions of 6.2 percent in defense programs and 8.4 percent in non-defense programs.

This year you estimate that reductions of $50 billion will require across-the-board reductions of 14 percent in defense programs and 20 percent in non-defense programs.

How much of the increased percentage reduction now estimated to be required under a sequester is attributable to:

(1) the Omnibus Budget Reconciliation Act of 1986 (P.L. 99-509)?

(2) the Veterans' Benefits Improvement and Health-Care Authorization act of 1986 (P.L. 99-576)

(3) any other enacted legisation, such as the Panama Canal Authorization Act, Fiscal Year 1987 (P.L. 99-368)?

Answer: The Omnibus Budget Reconciliation Act of 1986 exempted cost-of-living adjustment in federal retirement programs from sequestration. Other relatively small exemptions were added by other bills. These new exemptions increase the across-the-board reductions in defense programs by about 0.4 percentage points and in remaining nondefense programs by about 0.8 percentage points.

Scoring Of Reappropriations

Question: Both CBO and OMB score reappropriations--extensions of the time in which an appropriation is available for obligation--as new budget authority. CBO scores the new budget authority in the year in which the appropriation would otherwise not be available, while OMB scores the new budget authority by the fiscal year shown on the measure in which the extension is made.

Does CBO adjust the OMB historical data for the different scoring treatment of reappropriations? If not, why not?

Answer: CBO does not maintain a historical record for budget authority. Therefore, we do adjust the OMB historical data for the different scoring treatment of reappropriations.

Question: By what amount have you increased the President's FY 1988 BA estimate for reappropriations counted by OMB as FY 1987 BA?

Answer: We have increased the President's fiscal year 1988 budget authority estimate by $473 million for reappropriations counted by OMB as 1987 budget authority. The amounts by agency are as follows (in thousands of dollars):

Department of Commerce, General Administration	38,520
Department of Health and Human Services, Public Health Service	339,404
Department of Housing and Urban Development, Public and Indian Housing Programs	85,338
Department of Justice, Federal Bureau of Investigation	5,686
Small Business Administration	4,116
Total	473,064

Sequester Calculation And The President's Proposed Budget

Question: Under the terms of the Balanced Budget and Emergency Deficit Control Act of 1985, the prescribed maximum deficit in Fiscal Year 1988 is $108 billion. Using your calculations, the President's proposals exceed the maximum deficit by $26.4 billion.

Using your calculations and assuming that Congress enacts every item in the President's 1988 proposals by early August, by how much would the President's request for FY 1988 defense and non-defense appropriations have to be further reduced in order to meet the deficit target?

Answer: CBO estimates that the 1988 budget deficit under Administration policies would be $134.4 billion, which is $26.4 billion above the target. Eliminating this excess would require across-the-board reductions of roughly 7 percent for defense and 10 percent for nondefense programs. The Administration, of course, contends that its policies would meet the 1988 deficit target, and the figures in the August sequestration report will be averages of CBO and OMB estimates.

QUESTIONS SUBMITTED BY SENATOR BURDICK

Baseline Budget Authority

Question: Dr. Penner, based on my review of your preliminary baseline for fiscal year 1988, I would think that the following items should be added to it. These items are based on traditional and required spending by the subcommittee, as well as on the President's budget request. I would appreciate it if you would comment on each of these items and tell me whether or not CBO will include them in the baseline.

-- $21.134 billion for the Commodity Credit Corporation (CCC)?

Answer: The CBO baseline for each year includes budget authority sufficient to cover CCC activities for that year. Total baseline budget authority for CCC is $24.6 billion for 1988.

-- $15 million for departmental administration in hazardous waste management.

Answer: The President has requested $15 million for 1988 for hazardous waste management activities of the Department of Agriculture. There was no appropriation for this purpose in 1987, and thus it is not included in the baseline for 1988 or beyond.

-- $6 million for the Food and Safety Inspection Service.

Answer: The CBO baseline for 1988 is the 1987 appropriation inflated. The President's request is $6 million above that level, and that increment is not in the baseline.

-- $962 million for the Farmer's Home Administration (FmHA).

Answer: The CBO preliminary baseline budget authority for appropriations to the three FmHA loan funds was a total of $962 million lower than the Administration's request for these activities. The final baseline includes the Administration's request for appropriations to cover past losses plus $167 million for rural rental assistance payments. In total, baseline budget authority for appropriations to the three funds is $7,614 million, compared to the President's request of $7,607 million.

-- $96 million for the Federal Crop Insurance Corporation Fund.

Answer: The CBO baseline appropriation level for premium subsidies is $139 million to cover the federal subsidy for producer premiums. The CBO baseline is consistent with the recent practice of the Congress of providing appropriations for only the previous crop year's premium subsidies. The Administration's appropriation request for premium subsidies is $90 million higher than the CBO level because of an accounting change that results in a request to cover 75 percent of premium subsidies for the current crop year as well as all premium subsidies from the previous crop year.

— $37 million for the rural housing voucher program.

Answer: The President's proposed rural housing voucher program is a new program under consideration for 1988 and intended to replace the current rural rental assistance payments program. Because the baseline reflects 1987 spending policy, it includes no amounts for the proposed new program. The baseline does include funding for $168 million in 1988 obligations for the rural rental assistance payments program, based on the 1987 program level inflated.

— $79 million for the traditional reimbursements to the Rural Electrification Administration.

Answer: In the continuing resolution for 1987, the Congress appropriated $20 million to reimburse the rural electrification and telephone revolving fund for interest subsidies and prior-year losses. CBO's baseline for 1988 includes $21 million, which is the 1987 appropriated level adjusted for inflation.

— $4 million for the Colorado River Basin Salinity Control Program.

Answer: The CBO baseline for 1988 includes $4 million (in subfunction 304) for this purpose, the 1987 appropriation adjusted for inflation.

— $1.388 billion for the Conservation Reserve Program.

Answer: The CBO baseline includes $1.217 billion for the conservation reserve in 1988, based on CBO's estimates of the cost of enrolling in the reserve 10 million additional acres in fiscal year 1988. This would bring total enrolled acreage to the 25 million acres minimum mandated in the Food Security Act through fiscal year 1988. The Administration request for 1988 is $1.388 billion.

-- $47 million for child nutrition.

— $8 million for the special milk program.

— $8 million for Section 32 permanent appropriations.

Answer: These programs are all entitlement programs, and the CBO estimate of the required budget authority for 1988 differs from that of the Administration. For child nutrition and the special milk programs, the CBO estimates are a total of $55 million below those of the Administration. Since the preliminary baseline was prepared, CBO has revised its estimate for the Section 32 permanent appropriations; the required budget authority in the revised baseline is $28 million above the President's estimate for this program.

-- $121 million for Public Law 480.

Answer: The CBO baseline for 1988 and beyond assumes continuation of the obligation levels specified for this program in the 1987 continuing resolution, adjusted for inflation. These obligations are funded from a number of sources--offsetting collections, fund balances from previous years, and appropriations. Because CBO estimates that $101 million in unobligated balances will be available to fund 1988 activities, the estimated funding required through appropriations action has been correspondingly reduced.

Question: Your baseline shows a significant reduction for the P.L. 480 program. I believe the amount is roughly $121,000,000 in the appropriated level. Can you explain why your baseline would show such a significant decrease for P.L. 480?

Answer: For the P.L. 480 program, the base for projections is the obligation level specified in the fiscal year 1987 continuing resolution. The obligations may be funded from offsetting collections, unobligated balances, or budget authority in the form of new appropriations. The baseline budget authority is an estimate of the new appropriation required to finance a constant real program level. The $121 million reduction in budget authority results from an estimate that unobligated balances will be higher in fiscal year 1988 than in 1987. It does not imply a program reduction.

Borrowing Authority for CCC

Question: The President's budget request includes an increase in the borrowing authority for the Commodity Credit Corporation from $25,000,000,000 to $40,000,000,000. This is a $15,000,000,000 increase in its borrowing level.

— Should this increase be enacted by Congress, does it require an appropriation of $15,000,000,000 in order to activate it?

— Will this increase in borrowing authority increase budget authority for the committee by $15,000,000,000?

— What about outlays?

Answer: Under current procedures, borrowing authority, once enacted, is available to the Commodity Credit Corporation without further appropriation action.

Under present scorekeeping rules, an increase in CCC borrowing authority would be scored when used, not when provided. Thus, no budget authority or outlays would be scored against the committee at the time of the borrowing authority increase.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

Deficit Reduction

Question: Dr. Penner, you have said in testimony elsewhere that reaching the FY 88 Gramm-Rudman-Hollings deficit target of $108 billion from the FY 87 estimated deficit level of approximately $170 billion could be a disaster for the economy. I believe you have said that it might be better to cure our deficit addiction more slowly, rather than going cold turkey.

In that case, what do you think the appropriate FY 88 deficit target should be?

Does it make a difference to the economy if we achieve that target exclusively through spending cuts as opposed to a mix of spending cuts and revenue increases?

Answer: To improve the environment for capital formation and long-term economic growth, any deficit target should be low enough to demonstrate to the financial markets that the deficit is going to be significantly reduced. In my view, this would require a deficit reduction of no less than 1 percent of GNP, or roughly $45 billion, over and above any reduction achieved through asset sales and changes in budget accounting.

Various combinations of spending and tax changes could be used to reduce the deficit, and their economic outcomes would vary somewhat. But the choice of how much deficit reduction should be achieved through spending cuts and how much through tax increases should be guided by some conception of the appropriate size of government and the desired distribution of income, rather than by differences in likely short-run economic effects.

Possible Sequester

Question: I believe you have calculated that the next sequester under Gramm-Rudman-Hollings, if one ever occurred, would require a 20% reduction in non-defense and a 14% reduction in defense in order to meet the deficit targets. These percentages were proportionally larger than the ones required in March 1986. That indicates that the base against which the cuts are made has been narrowed. Is that the case? For example, weren't there some exemptions from sequester included in last year's reconciliation bill, further corrupting the Gramm-Rudman-Hollings notion of across-the-board cuts?

Answer: The increase in the required sequestration percentages results primarily from the increase in the excess deficit--from $11.7 billion in fiscal year 1986 to an estimated $50 billion in fiscal year 1988. Largely because of the application of special rules to certain programs, however, the required across-the-board reductions are not strictly proportional to the size of the excess deficit. The exemptions from sequestration which were added last year increase the across-the-board reduction in defense programs by about 0.4 percentage points, and in remaining nondefense programs by about 0.8 percentage points.

QUESTIONS SUBMITTED BY SENATOR STEVENS

CBO Spending Options

Question: Of the options presented in the CBO study, which would you consider the most promising as approaches to reducing spending?

Answer: CBO's recent publication Reducing the Deficit: Spending and Revenue Options lists 77 potential spending cuts. Many of these options were considered by past Congresses and were not enacted. Whether they will be enacted in the future depends on political circumstances. CBO's mandate to be objective and nonpartisan prevents us from making recommendations.

Question: What parameters guided your staff in evaluating those programs identified in your report as candidates for cancellation or deferral?

Answer: Let me answer with reference to the defense section of the CBO study Reducing the Deficit: Spending and Revenue Options (January 1987), which evaluates deferral or cancellation of a number of weapon systems. We intentionally choose examples of potential reductions that cover many areas of the defense budget: operating and support, strategic and conventional systems, systems from each of the military services. Specific options are chosen because there is an analytic rational—requirements may have changed, for example, making deferral or cancellation of a system more attractive—or because authorities in the Congress, the Administration, or elsewhere have raised concerns about requirements for the system or its performance or costs. In all cases we try to make clear the disadvantages of canceling or deferring particular weapon systems along with arguments in favor of the change.

Question: If the Congress were to provide sufficient growth in the defense budget to cover only the increased Operation and Support costs on current and planned systems, how much additional money will be required? What percentage real growth does that represent?

Answer: Operation and support cost estimates are especially uncertain because actual costs are not readily observed—nowhere are they separately identifiable in the budget. For example, nowhere does the Army show the incremental costs or savings of operating a new system compared to the system(s) it replaces. Similarly, Navy and Air Force budgets do not indicate the indirect costs of operating specific systems. Consequently, analysts must infer O&S costs from relationships between forces and fairly broad categories of military personnel, operation and maintenance, family housing, and even procurement funding.

Based on current O&S policies as reflected in appropriations action, force growth planned for 1988 would raise costs by about $1 billion to $1.5 billion--or about 1 percent of O&S costs. In 1992, the force growth would add about $4 billion in O&S costs for average annual real growth of about 0.5 percent. These estimates do not anticipate any efficiencies in operations that would reduce costs, but neither do they anticipate added real costs--averaging perhaps 3 percent per year--from weapons and equipments that are more complex if not more numerous than their predecessors.

Question: Your report estimated that earlier retirement of B-52G bombers beginning in 1990 would save almost $5 billion in FY 1988-92. How did you arrive at this estimate, and what would be the total available savings if other old weapons systems were retired rather than extended for additional service?

Answer: Our estimate assumes that 45 B-52G bombers would be retired in the middle of 1988--to yield half of the ultimate annual savings--and that another 45 bombers would be retired in the middle of 1989. The first year of full savings from retiring 90 bombers would be 1990, when funding would be about $1.2 billion lower than CBO baseline and President's budget levels. The estimate assumes that direct savings occur from not operating the aircraft, and that indirect savings occur by reducing the support establishment attributable to the aircraft and crews.

The answer to your other question depends on what forces would be retired and the timetable for retirement. We are working with your staff to answer this question.

CBO Baseline Issues

Question: Do you foresee a mismatch for FY 1988 in the budget authority requested to available outlays?

Answer: Senator, I believe your question is based on the perception of some that budget resolutions of the past two years have had outlays too low relative to the budget authority. It was quite possible to allocate budget authority to meet the resolution's targets, but not if funding for faster-spending accounts exceeded certain levels.

And so, Senator, you have asked me a very difficult question. We do not yet have a budget resolution nor bills from the Appropriations and Armed Services Committees with which to compare total budget authority and outlays. In the end, CBO cannot judge whether there is a mismatch or not because it depends on political judgments as to what should be funded and what should not be funded. I can only assume that the Congress will balance programmatic pressures with deficit reduction pressures.

Question: To what would you attribute the small difference in estimates for the defense portion of the budget?

Answer: CBO's estimates of defense outlays for the years 1987-1992 are never more than $1.1 billion higher than the Administration's estimates; for two years, 1987 and 1992, CBO estimates lower outlays. These differences are much less than those of a year ago because the Administration has raised its estimates by resuming use of historical spending patterns in making its estimates.

Question: Will you provide for the record a reestimation of a "no real growth" budget using the percentage mix of programs requested in the President's budget rather than last year's appropriation bill?

Will you provide for the record a reestimation of outlays based on the budget request for 1% real growth and for 2% real growth?

Answer: Below is a table that shows the budget authority and outlays for zero, 1 percent, and 2 percent real growth in the defense budget. These real growth totals are based upon the President's pay raise and CBO forecasts for defense purchases inflation. The outlays are those that would result if the mix of programs requested by the President were maintained.

PROJECTIONS FOR NATIONAL DEFENSE BUDGET AUTHORITY AND OUTLAYS FOR FISCAL YEAR 1988 BASED ON THE MIX OF PROGRAMS IN THE ADMINISTRATION'S REQUEST

(In billions of dollars)

	Budget Authority	Outlays
0% Real Growth	303.0	293.1
1% Real Growth	306.0	294.9
2% Real Growth	309.1	296.6

QUESTIONS SUBMITTED BY SENATOR D'AMATO

Question: Does CBO have an analysis of the impact of 1987 and 1988 budget proposals on the war on drugs?

Answer: CBO does not have an analysis of the impact of 1987 and 1988 budget proposals on the war on drugs.

Follow-up: Do you have the ability to produce such an analysis, in terms of how many drug law enforcement personnel we will be able to hire, the Customs and Coast Guard Air and Marine interdiction program, drug eradication programs, and the other aspects?

Answer: It is difficult to separate amounts included in each account for new drug initiatives from amounts for ongoing drug initiatives or other, unrelated activities also covered by that account. Therefore, we cannot estimate in advance the number of new personnel for drug law enforcement that may be hired, because the amounts provided for each account may be used for other purposes.

Question: I am very concerned that OMB has been playing games with the Customs Service's drug interdiction program. Is it true that OMB's proposal includes:

— A rescission in 1987 of $38.945 million?

Answer: Yes. The President has proposed to rescind $38.945 million (5 percent) of the 1987 appropriation for salaries and expenses, of the Customs Service salaries and expenses.

-- A delay in obligating $32.099 million until FY 1988?

Answer: Yes. The Administration is delaying obligating $32 million of the 1987 appropriation for the air interdiction program of the Customs Service, because it is seeking to reprogram for other purposes some of the funds earmarked for construction of a command, control, communications, and intelligence center. Legislation has been submitted that would allow it to do so.

-- A reduction of $119.649 million in 1988 below the amounts provided in the 1987 continuing resolution?

Answer: Yes. The 1987 continuing resolution (Public Law 99-591) provided nearly $1.01 billion in new budget authority for the Customs Service; the President's request for 1988 is $890 million, which is approximately $120 million below the 1987 level.

A comparison of the funding for the two years is shown below.

Customs Service Appropriation
(in millions of dollars)

	Public Law 99-591	1988 Request	Difference
Salaries & Expenses	830	803	-27
Air Interdiction	171	86	-85
Payment to Puerto Rico	8	---	-8
Total	1,009	889	120

The Customs Service also has direct authority to spend approximately $70 million for overtime expenses. The funds that pay for these expenses come from customs user fees enacted in the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 (Public Law 99-272).

— A reduction in the Customs Forfeiture Fund from $18 million to $10 million?

Answer: Yes. The Continuing Resolution provided a 1987 appropriation of $18 million for the Customs Forfeiture Fund. The President's budget for 1988 includes a request of $10 million for that fund.

-- and a very questionable handling of the new Customs user fee? It is my understanding that OMB is allocating approximately $417 million of the new Customs user fee account to general revenues, rather than directly to a Customs Service account.

Answer: The new Customs Service user fees were enacted in two separate pieces of legislation. COBRA (Public Law 99-272), enacted in April 1986, imposed entry fees on vessels, trains, trucks, and airline passengers beginning in July. The Customs Service deposits these fees in a general fund receipt account in the Treasury, and both OMB and CBO count these receipts on the revenue side of the budget, consistent with the treatment of customs duties. The Secretary of the Treasury is required to use these receipts--which CBO estimates will total $220 million and OMB estimates will total $157 million in 1987--to pay for certain overtime expenses of the Customs Service. Any receipts that are not used to pay for overtime expenses do not accumulate in the general fund receipt account from year to year.

The Omnibus Budget Reconciliation Act (OBRA) of 1986 (Public Law 99-509), enacted in October, imposed an additional user fee in the form of an 0.22 percent charge on the value of certain merchandise imports, effective December 1, 1986. The Treasury deposits these fees into a special fund receipt account that is identified as a customs user fee account. Again, both OMB and CBO count the OBRA fees on the revenue side of the budget. CBO estimates that these fees will total $506 million in 1987, and OMB estimates they will total $417 million. Under the OBRA legislation, the Congress is authorized to appropriate from this special fund receipt account the amount necessary to fund the annual expenses of the commercial operations of the Customs Service. Based on this authorization, the President has requested a 1988 appropriation of $499 million from this special fund for the commercial operations of the Customs Service. Any amounts that are deposited in the account, but are not appropriated, will accumulate in the account from year to year and will remain available for future appropriations.

Follow-up: With respect to the delay in telling us what OMB's plans are for the $32 million for the air program, is there a precedent for this that you are aware of?

Answer: The Administration has used reprogrammings of budget authority many times in the past. Details regarding proposals in the President's budget are frequently not available until proposed legislation is transmitted to the Congress.

Follow-up: I have seen estimates that the FY 1988 budget proposal provides funding for 2,000 fewer Customs positions than the 1987 Continuing Resolution allows. Can you comment on that?

Answer: The President's request for 1988 contains 1,868 fewer full-time equivalent positions than the 1987 continuing resolution. The following table summarizes the staffing levels in the 1987 continuing resolution and the President's requests for 1987 and 1988.

	Full-time Equivalent
1987 President's Request	13,677
1987 Continuing Resolution	15,037
1988 President's Request	13,169

Question: Does CBO differ from OMB in the way it accounts for the Customs Service or the Immigration and Naturalization Service (INS) user fee? I understand that OMB may be counting on these fees to reduce the deficit by about $500 million rather than to increase services.

Answer: Both OMB and CBO count the receipts from the Customs user fees on the revenue side of the budget. The same is true of the INS user fee. The Congress did not require that the fees be used to "increase services," and did not establish any budgetary mechanism that would have that effect. The decisions as to how much is spent for Customs Service and INS activities are made primarily through the appropriation process, and are not directly linked to the amount of fees collected.

Question: Can you explain how CBO's assumptions differ from those of OMB with respect to outlays and spendout rates for key law enforcement agencies, such as the Customs Service, Drug Enforcement Agency, and the U.S. Attorneys?

Answer: CBO and the Administration have slightly different assumptions about the rate at which individual agencies outlay funds, but don't differ greatly on estimates of total law enforcement spending. A comparison of their estimates of first-year spendout rates and total 1988 outlays for selected law enforcement programs is shown below (in percentages and millions of dollars):

	1988 Budget Request		CBO Restimate of Request	
	Rate	Total Outlays	Rate	Total Outlays
FBI	76.4	1,472	80.0	1,446
DEA	80.0	512	86.0	513
INS	85.5	875	88.0	901
Customs Service				
Salaries & Expenses	98.0	879	90.5	861
Air Interdiction	80.0	147	55.0	137

Follow-up: Does OMB generally assume a slower pace of hiring new people than CBO assumes?

Answer: We are not aware that there is any overall pattern of differences between the two agencies in assumptions about the pace of hiring new people.

Follow-up: What effect do OMB's stated assumptions about spendout rates have on agency hiring practices? Do the agencies tend to follow OMB's assumptions about spendout rates in their hiring practices?

Answer: This question is difficult to answer, because OMB does not usually develop the spendout rates. For each agency, OMB specifies the number of full-time equivalent positions; the agency then calculates the outlays from new budget authority needed to support those positions. Thus, the process actually works the other way--the hiring practices determine the pattern of cash disbursements from the agency and thus the outlay estimates.

SUBCOMMITTEE RECESS

Chairman Stennis. Thank you very much, again.

Dr. Penner. Thank you, Mr. Chairman.

Chairman Stennis. I look forward to further contact with you.

[Whereupon, at 11:23 a.m., Thursday, February 19, the committee was recessed, to reconvene at the call of the Chair.]

BUDGET OVERVIEW FOR FISCAL YEAR 1988

THURSDAY, FEBRUARY 26, 1987

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10:02 a.m. in room SD-192, Dirksen Senate Office Bulding, Hon. John C. Stennis, (chairman) presiding.

Present: Senators Stennis, Sasser, DeConcini, Lautenberg, Reid, Hatfield, Weicker, Garn, Cochran, Kasten, D'Amato, Grassley, and Nickles.

DEPARTMENT OF THE TREASURY

STATEMENT OF THE HONORABLE JAMES A. BAKER III, SECRETARY OF THE TREASURY

OPENING STATEMENT OF CHAIRMAN STENNIS

Chairman STENNIS. This is a full committee meeting of the Appropriations Committee of the U.S. Senate. That means we have money jurisdiction overall the funds that may be appropriated and forwarded here.

We are delighted to have a number of visitors here. I had a chance to meet some of them. They are from Tucson, AZ. They are well represented here on our committee by my good friend Senator DeConcini. They are learning early and learning fast. That is part of my doctrine. I wanted to give a professional word of welcome and encourage them to come back next year.

It is our privilege today to have with us the Secretary of the Treasury. One of the most important positions in our Government, and one of the most difficult, too.

Mr. Baker is a very capable gentleman, and he knows his subject. It will be worth a lot to the membership of our committee and all Members of the Congress to have his opinions pinpointed and put in the record here. Of course, this hearing is open to all members and all people, particularly the press and media, who help get our message out to the country.

I am delighted that we can have you with us, Mr. Secretary. I am going to say a few words on the general situation of our committee and then call on you. We will have questions by members of the committee just as soon as we can promptly reach that point.

This morning, the Appropriations Committee begins the third of the overview hearings on the President's proposed budget for fiscal year 1988. Today, we will hear from the Honorable James A. Baker III, Secretary of the Treasury, on the state of the economy, the administration's budget and the President's proposal for deficit reduction.

Earlier this month, we had hearings with Dr. Rudolph Penner, Director of the Congressional Budget Office, at which time he presented his annual analysis of the President's budget.

It is a privilege for me, as I have said, to welcome the Secretary to this meeting to testify here and for our records, for the benefit of all, and we look forward to his statement and maybe further statements that we may ask you to give at some later date.

Senator Hatfield from Oregon, the former chairman of this committee and who now is the ranking minority member, is planning to be at the meeting. We will certainly call on him when he does get here.

We are faced, gentlemen of the committee, and all the Congress and the people, for the first time are faced with what we call the first $1 trillion budget request ever submitted by a President. This is a great deal of money. It has a great deal of meaning behind it.

I am not just fishing in the dark. I honestly believe that we can meet the occasion. I know we must if we are going to retain our real basic freedoms, the great principle in our system of government. Like that old quote from some of the forebearers who wrote our Constitution, like Benjamin Franklin, he said he was determined that in America, the people would govern. That is what was adopted, and that is what we have thrived on for 200 years. We now are having some trouble, but it can be solved, and I think we will do so.

PREPARED STATEMENT

I am going to ask unanimous consent here that all of my remarks be included in the record at this point.

[The statement of Senator Stennis follows:]

PREPARED STATEMENT OF HON. JOHN C. STENNIS

U.S. Senator From Mississippi

This morning the Appropriations Committee begins the third of the overview hearings on the President's proposed budget for fiscal year 1988. Today we will hear from Hon. James A. Baker III, Secretary of the Treasury, on the state of the economy, the administration's budget, and the President's proposals for deficit reduction.

Earlier this month, we had hearings with Dr. Rudolph Penner, Director of the Congressional Budget Office, at which time he presented his annual analysis of the President's budget.

It is a privilege for me to welcome you, Secretary Baker, to this committee and to these proceedings which we all view as critically important. We all look forward to hearing your statement as it relates to the President's proposed budget for fiscal year 1988. Before we do so, however, I would like to make a few general comments.

As one who has had the distinct honor to have served as a member of this committee for the past 32 years, and to now serve as its chairman, I am especially mindful of the challenge our country, this Congress, and our committee face today as we confront the first trillion dollar budget request ever submitted by a President.

As many of my colleagues know, I accepted this chairmanship with the idea of establishilng goals and priorities which will hopefully enable this committee to work with the administration in bringing the Federal budget deficit under control.

I say this because I am truly concerned about the serious problems which exist and the difficult choices which must be made if we are to be successful in this joint venture. Let me briefly explain.

THE TRADE DEFICIT

I am concerned that the U.S. trade deficit, which in 1981 stood at $40 billion, stands today at $170 billion. By contrast, three of our major trading partners—Japan, Canada, and West Germany—enjoyed a total trade surplus with the United States alone of almost $100 billion. Now, at a time when competition from foreign nations is greater than ever, we must seek stronger measures to ease our trade imbalance.

THE NATIONAL DEBT

I am concerned that the U.S. national debt, which in 1981 stood at roughly $1 trillion as a result of 200 years of inherited bills for public spending on such important events as acquiring the Louisiana Purchase, holding the Union together, overcoming the devastation of the Great Depression, and winning two world wars, now stands today—just 6 years later—at roughly $2½ trillion. Our fellow citizens may not view the recent $1½ trillion addition of the past 6 years as comparable and equal to the value which our country derived from 1776–1980.

THE FEDERAL BUDGET

I am concerned that as we confront the first $1 trillion budget request ever submitted by a President, we in the Congress remain mindful of our solemn obligation to act in a timely and meaningful way toward the orderly presentation of the 13 major appropriations bills. As we all know, the 1985 Balanced Budget Act—popularly known as Gramm-Rudman-Hollings—requires that Congress complete action on a concurrent budget resolution by April 15 and that the House of Representatives complete action on all regular appropriations bills by June 30. Although there is no deadline set out in the act regarding Senate action on appropriations bills, it is my fervent hope and strong intention that this committee, and we in the Senate, act in a timely fashion to complete the appropriations process by October 1.

THE BUDGET DEFICIT

Finally, I am concerned that this committee and this 100th Congress adopt a budget plan for 1988 with a deficit no larger than $108 billion. Last year when the Director of the Office of Management and Budget testified before this committee, he stated that the President's budget would meet the Gramm-Rudman-Hollings target of $144 billion in fiscal year 1987. As we have recently been informed, the 1987 deficit has exceeded the $144 billion target by $30 billion. At last week's hearings, the Director of the Congressional Budget Office predicted that the likely excess deficit for 1988 may be $63 billion.

Clearly, our work is cut out for us. The problems we face are sizable but not—and I repeat, not—insoluble.

And although we may not agree with all the details of the President's 1988 budget submission, we are mindful that any deficit equal reduction proposal that we reject must be replaced by one with equal or greater savings. For if we do not, we may not achieve the fiscal year 1988 deficit target of $108 billion.

Accordingly, let us take this budget proposal which the administration has submitted and add our best efforts toward formulating a budget for 1988 that will guide our Nation toward a path of continued strength and vitality.

I know that the members of this committee are anxious to contribute to the process, and with that in mind, Mr. Secretary, we look forward to your presentation.

INTRODUCTION OF SENATOR HATFIELD

Chairman STENNIS. I want to yield to the former chairman of our committee here, where he did such an outstanding service, Senator Hatfield from Oregon.

Senator?

Senator HATFIELD. Thank you, Mr. Chairman.

Chairman STENNIS. We just started here.

Senator HATFIELD. I thank you, Mr. Chairman. I may have some remarks that I would like to have inserted in the record later, but I do not have any at this time, and I would like to welcome Secretary Baker to the committee.

Chairman STENNIS. We will come back to you at a convenient time. In the interest of time, I am going to tell the Secretary, again, that he has a very wholesome welcome here. We feel that he is highly competent in the field in which he serves and that he will be helpful to the committee.

We have a number of questions here that are carefully prepared for him at the proper time, but now, that all may hear, I am going to call on the Secretary. He is ready to proceed.

PREPARED STATEMENT

Secretary BAKER. Thank you very much.

Chairman STENNIS. You proceed now in your own way, and we will have a chance later to ask you questions and you will have a chance to answer. Thank you very much.

Secretary BAKER. Thank you, Mr. Chairman. I will, if it is all right with you and the committee, summarize my prepared testimony and ask that the full statement be submitted for the record.

Chairman STENNIS. All right. Without objection, that request will be granted.

[The statement of Secretary James A. Baker follows:]

PREPARED STATEMENT OF HON. JAMES A. BAKER, III

SECRETARY OF THE TREASURY

Mr. Chairman and Members of the Committee:

It is a pleasure to meet with you today to discuss the state of the economy, the Administration's Budget, and our proposals for deficit reduction.

1986 in Review

During 1986, the United States Government took two historic steps that hold the promise of improving American economic performance for years to come.

First, the forces set in motion by the President in his State of the Union Address of three years ago culminated in Congress' enactment last summer of a comprehensive reform of our tax system. This bipartisan effort created a fairer, more equitable tax system -- one which enhances economic efficiency and strengthens incentives for increased economic progress. Tax reform should remove about 6 million Americans from our income tax rolls. It slashes the top statutory individual tax rate to less than half the top rate when President Reagan took office. And it focuses capital on productive uses, not tax uses.

Second, the Tokyo Summit laid the foundation for sustained world economic growth by starting to provide procedures for improved coordination of economic policies among the leading industrial democracies. This past weekend in Paris, we took another step forward in our efforts to promote closer, more effective coordination of economic policies. Agreement was reached on concrete steps to achieve more balanced growth and a reduction of trade imbalances. These measures should also foster greater stability of exchange rates around current levels.

The record for the year 1986 was generally favorable -- though we aspire for continued improvement. To summarize briefly:

- The current expansion has extended into its fifth year, exceeding in duration 5 of the previous 7 expansions. There is every prospect that the current expansion will continue unabated through 1987 and the years beyond. Despite the longevity of this expansion, it has led to few if any of the imbalances that marked the latter stages of previous cyclical expansions.

- The increase in consumer prices during 1986 was less than in any year in more than two decades. For the millions of elderly Americans who fear the erosion of hard-earned savings from inflation, this affirmation of our earlier accomplishment is most welcome. Over the past six years, inflation has been cut drastically from the nearly 13 percent averaged in 1979 and 1980 to 4 percent or less for the last five years.

- The number of persons holding jobs increased by 2-1/2 million during the year. Throughout the present expansion the number of jobholders has risen by almost 12 million -- lifting the percentage employed of the civilian population to the record level of 61.1 percent.

Interest rates continued to decline. The prime rate is down 2 full percentage points from early January 1986 (down two-thirds of what it was in early 1981), and at 7-1/2 percent is the lowest in more than nine years. Other rates, both short- and long-term, are down about 1-1/2 percentage points from a year ago. This has been particularly good news for young people striving to buy their first homes or refinancing high rate mortgages. Policies of the Federal Reserve assured that ample credit was available.

I would submit to you that this is a solid economic performance. Nevertheless, we still have much work to do. The progress of 1986 should set the stage for an even better year for real economic growth and employment in 1987.

1987 Forecast

To summarize our economic forecast, we expect real growth to average 3-1/4 percent across the four quarters of this year. This estimate is about in line with the private forecasters' consensus of growth slightly below 3 percent. It is a little faster than the roughly 2 percent averaged during the four quarters of 1986, but signs were emerging in the latter part of last year that the economy may be gaining momentum. Statistics early this year have generally been encouraging.

We cannot expect inflation to remain quite so moderate in 1987 as in 1986, which benefited from the fall in world oil prices. Still, no resurgence of inflation is in prospect, and we expect the GNP deflator to increase by about 3-1/2 percent across the four quarters of the year, with consumer prices rising by a shade more than that.

For the longer term, it is reasonable to expect the economy to grow at least a little above trend until a fuller rate of resource utilization has been reached, and that is incorporated into our forecast. Our longer-term forecast also envisions that we will maintain and improve upon our progress in bringing down the rate of inflation.

International Economic Outlook

Experience of recent years has brought home to all of us here today just how interdependent the world economy has become. The effect on large segments of U.S. industry of deteriorating U.S. trading accounts has been painfully clear in this country. At the same time, our efforts to contain inflation have been aided importantly at various junctures by an appreciating dollar and declining international commodity prices. Nor can we overlook the role that capital inflows from abroad have played in supporting our own economic expansion.

The large U.S. trade deficit reflects the myriad linkages between our economy and the rest of the world. Exchange rate changes, the strong pace of U.S. economic growth relative to that of other major industrial countries, and the debt problems of the developing countries all have influenced our trade deficit. Our future performance on these counts will determine in large part our success in reducing that deficit.

During the past year, we have made progress in establishing the fundamental conditions for balanced global growth and a reduction in external imbalances. The dollar has now depreciated substantially vis-a-vis the currencies of the other major industrial countries since its February 1985 peak; two-thirds of the adjustment occurred since the Plaza Agreement of September, 1985. The dollar has declined 40-50 percent against the yen and the deutschemark since its early 1985 peak. Moderate growth has been sustained in the industrial countries, and the nonoil exporting developing countries over the past year have turned in a fairly strong growth performance. Rates of inflation in the industrial countries have, with an assist from the decline in oil prices, fallen to the lowest levels since the 1960s. Key interest rates have continued to trend down. Progress has also been made in reducing fiscal deficits in the major industrial countries to more manageable levels.

Many observers believe external imbalances among the major industrial countries may have peaked last year. The U.S. current account deficit probably reached about $145 billion in 1986 (actual figures due in March), while the current surpluses of Japan and Germany were around $86 billion and $36 billion, respectively. Many forecasters think it likely that our current account deficit will decline this year to around $130 billion and that the Japanese and German surpluses will decline somewhat as well.

The effects of the exchange rate changes over the past two years on our international trade balance have not yet proved as quick or as strong as had been expected from past experience. However, exchange rate changes have contributed to a leveling out of what had been an upward trend in our trade deficit.

More importantly, we are confident that the cumulative effect of the exchange rate changes thus far will contribute significantly to a reduction of our trade deficit this year.

While the exchange rate changes over the last two years have been necessary to reduce external imbalances among the major industrial countries, they alone are of course not sufficient. This explains why we have given such attention to the pace and pattern of growth among the industrialized countries.

By strengthening the process of achieving improved economic coordination among the leading democracies, the Tokyo Summit agreement of last May helped lay the foundation for cooperative policies designed to promote sustained world economic growth. At our meeting this past weekend in Paris, the Finance Ministers and Central Bank Governors of a number of our major industrialized countries moved these efforts forward another step.

At the meeting, the surplus countries committed themselves to strengthen their growth prospects, while the deficit countries agreed to reduce their domestic imbalances. More specifically, Germany indicated that it plans to proceed with a major tax reform and to increase the size of its tax cuts scheduled for 1988, in addition to the recent action to lower its interest rates. For its part, Japan announced a cut in its discount rate to 2.5 percent and committed itself to prepare a comprehensive economic program to stimulate domestic demand.

The U.S. must also do its share. We must press forward with reductions in the Federal budget deficit. And we must continue to oppose protectionist pressures.

I believe the actions and commitments set forth in Paris help establish the basis for more balanced growth and a reduction in imbalances between the surplus and deficit countries.

The Minister and Governors concluded that the substantial exchange rate changes since the Plaza Agreement have now brought their currencies within ranges broadly consistent with underlying economic fundamentals and that further substantial exchange rate shifts could damage growth and adjustment prospects. In current circumstances, they therefore agreed to cooperate closely to foster stability of exchange rates around current levels.

Responsibility for actions contributing to the adjustment of our major external imbalances does not rest with the major industrial countries alone. The newly industrialized countries in Asia have also come to play a major role in international trading patterns. Open markets contributed much to the development of these economies, and many of the NICs are now ready to be brought into the world trading system as full-fledged participants. One essential element will be that they follow policies that allow their currencies to better reflect economic fundamentals. And they must open their markets to both foreign trade and investment.

As part of our international trade strategy, our GATT negotiators will press ahead with the Uruguay round, including updated rules to encompass agriculture, services, investment, and intellectual property rights. We are pursuing key bilateral talks with Japan in the MOSS negotiations and with Canada in the free trade area negotiations.

The Administration will also continue to attack aggressively unfair trade practices of our trading partners. President Reagan is the first President to self-initiate Section 301 cases. Our active enforcement has produced results with a number of countries.

While pursuing our efforts internationally, we must also move ahead domestically to strengthen our international competitiveness. We will work with the new leaders in Congress to produce responsible legislation to enhance America's competitiveness and to avoid the backward-looking protectionist response. "The Trade, Employment, and Productivity Act of 1987" submitted by the President offers the basis for this joint effort.

It is clearly time for our exporters to benefit from greater growth abroad and a more reasonably valued dollar. If they are to have access to markets abroad, however, we must maintain the openness of our own market. We could not pick a worse time than the present to unfurl the banner of protectionism.

International Debt

This Committee is well aware of the myriad linkages between debt and trade, as well as their common connection to global growth and financial stability. We all have a stake in constructively addressing international debt difficulties -- not via quick-fix gimmicks, but through lasting solutions to underlying problems.

I know that many of you are concerned by Brazil's suspension of interest payments to commercial banks. As I indicated in Paris, we regret that Brazil felt compelled to take this action. We expect a timely resolution of the situation in the context of Brazilian negotiations with its private creditors, which began yesterday.

The Brazilian situation reflects their decision to prevent an uncontrolled rundown of foreign exchange reserves and a repeat of the near total collapse in reserves experienced in 1982. Brazil reports that reserves now stand at just under $4 billion, more than sufficient for normal trade operations. The government of Brazil has indicated its intention of meeting all its obligations, notwithstanding the suspension of interest payments.

I recognize that it is politically tempting to search for dramatic gestures which could sharply reduce debt service burdens overnight, or significantly increase the financial resources available to debtor nations to import our goods. Across-the-board debt forgiveness, in this light, may have some mistaken appeal, but would ultimately damage both debtor nations and the global economy. External capital would be available to debtors at prohibitive prices, if at all; bank losses would weaken some of our important financial institutions; and U.S. budget and taxpayer costs would increase significantly.

Similarly, calling for massive new lending (by others) to the debtor nations, either bilaterally or through a new multilateral fund, may appear to offer an easy way to boost U.S. exports and growth in the debtor nations. But without fundamental policy reforms, neither U.S. exports nor debtor growth can be sustained for the longer term. Throwing money at the debtor nations won't solve their problems; it will, in fact, worsen their difficulties unless the new financing can be productively absorbed and is consistent with their ability to grow and service debt.

In contrast to these "overnight" solutions, our debt strategy focuses on improving the debtors' growth potential through both macroeconomic and structural reforms, supported by modest new financing essential to meet immediate needs. Despite the relatively short period which has passed since we proposed this initiative, considerable progress has been made.

- Many debtors are already taking important steps toward increasing savings and investment, improving their economic efficiency, privatizing public enterprises, and encouraging the return of flight capital.
- The IMF has negotiated new standby programs with 8 of the 15 major debtors since October 1985, including new loan commitments of about $4.7 billion.
- The World Bank has negotiated $2.9 billion in new policy-based loans with 10 major debtors, and has discussions underway on nearly $5 billion in additional policy-based loans. Aggregate World Bank loan commitments to these debtors increased by 40 percent during its Fiscal Year 1986, and a substantially larger share of loans are now based on structural policy reforms.
- Finally, the commercial banks are also moving to make new loans available, as exemplified by the recent $7.7 billion package for Mexico, a $320 million new money package for Nigeria, and a $220 million oil facility for Ecuador. Nearly $70 billion in debt reschedulings have been negotiated with the major debtors since October 1985. A number of other financing packages and reschedulings are also now under discussion.

Externally, interest rates have been reduced by nearly 5 percentage points since 1984, saving the major debtors over $13 billion in interest payments annually. Efforts are underway to achieve stronger growth in other industrial nations, and to open global markets through the new multilateral trade negotiations.

This is a start -- a good one. We hope for further progress, but realistically must recognize that it will be gradual and will vary among nations, depending upon their own determination to implement growth-oriented reforms and the continued active support of the international community. That is the task before us, and the only true solution to international debt problems.

The MDBs are a particularly important vehicle for promoting growth-oriented reforms and for furthering U.S. foreign policy objectives. We, and other member countries, have succeeded in persuading the MDBs to advocate financing in support of difficult, but much-needed structural and sectoral growth-oriented reforms which are a central element of the debt strategy.

We also have succeeded in convincing other donor countries to increase their support of the MDBs. For instance, the Japanese increased their contribution to the eighth replenishment of IDA by $450 million to bring their share to almost 21 percent of the total, and the United Kingdom, the West Germans and other European countries also made additional special contributions to IDA. In total these increased contributions result in an IDA VIII of nearly $12.4 billion and a U.S. share of 23 percent, 2 percent less than the 25 percent U.S. share negotiated for IDA VII.

The United States clearly has significant influence in the MDBs. However, U.S. influence will diminish if we are not able to fulfill our commitments to these institutions. Consequently, it is essential that Congress support the Administration's FY 1987 supplemental request of $293 million and our FY 1988 request of $1.8 billion.

In a period of tight budgets, the cost effectiveness of the MDBs offers another reason for support: one dollar of U.S. budgetary authority for the World Bank translates into $60 of World Bank lending authority. About 90 percent of MDB lending also supports countries of importance to the United States, some of which receive little or no U.S. foreign assistance, such as Mexico and Argentina.

Budget and Deficit Overview

We have come a long way over the past six years. Still, there is a major item of unfinished business on the fiscal agenda -- further reduction of the Federal budget deficit.

We have reached a turning point on the deficit. Measures already taken have pointed us in the direction of reduced deficits through spending restraint. Even if one assumes pessimistic economic forecasts, we already have put in place reforms that should lower the 1986 Fiscal Year deficit of $221 billion to roughly $175 billion in Fiscal Year 1987 on a current services basis -- from 5.3 percent of GNP to 3.9 percent -- with further reductions in later years.

Even this substantial reduction can and should be improved upon. The President's Budget provides a plan for further substantial progress. If the proposals in the Budget are adopted, the deficit would shrink substantially for the second consecutive year and would drop to about 2.3 percent of GNP in Fiscal Year 1988. When it passed the Gramm-Rudman-Hollings Act, the Congress set a deficit target of $108 billion for Fiscal Year 1988. We are submitting a budget that hits this target without raising taxes.

The deficit should be reduced by reducing the scope of government, rather than through tax rate increase. The American people are not undertaxed. As shown by the first chart attached to my statement, revenues as a share of GNP projected over the next six years are about one full percentage point above the historical average for the period 1964 to 1979. In contrast, the outlay share of GNP in the past two fiscal years was about four percentage points above the historical average.

Our budget cuts the growth in spending. Outlays will continue to grow in absolute terms along the path projected in the new budget, but the rate of advance will be reduced significantly. Between FY 1986 and FY 1992, nominal Federal outlays would rise on average about 3 percent per year. In the prior six-year period, 1980-1986, the rate of growth was about 9 percent per year. Along the path projected in the new budget, Federal outlays would decline steadily as a ratio to GNP from just under 24 percent in 1986 to just over 19 percent in 1992.

Receipts will be growing strongly in absolute terms as the economy itself grows, and as previously scheduled payroll tax increases become effective in 1988 and 1990. Receipts are projected to rise by an average of 7.6 percent annually between FY 1986 and FY 1992, slightly above the 6.8 percent rise averaged in the previous six-year period. Receipts as a share of GNP will rise from 18.5 percent in 1986 to 19.4 percent in 1991 and 1992.

A number of other turning points are projected in the FY 1988 Budget. These turning points are important for the stability of the credit markets and continuation of low interest rates and economic expansion. As the second attached chart shows, beginning in FY 1987, interest payments on the debt will be falling as a share of the budget, permitting faster growth in other outlay categories. As the third attached chart shows, by FY 1988, the economy will be growing faster than the national debt. By FY 1990, the national debt will be rising less rapidly than the rate of inflation, and will actually be falling in real terms.

Fundamental to good governance is the ability to set priorities. This budget shows that eliminating the deficit is possible without raising taxes, without sacrificing our defense preparedness, and without cutting into the safety net for the poor and elderly.

Other programs basic to our national interest also should be properly funded. Some -- like basic scientific research and the space program -- will help keep America strong as we prepare for the 21st Century. Others -- like drug enforcement, AIDS research, and reduction of infant mortality -- will safeguard the soul of America, her people.

Approach to Deficit Reduction

We have approached deficit reduction somewhat differently this year. There is less reliance on programmatic reductions, and we are not relying substantially on spending cuts previously submitted and rejected by Congress. We are proposing $18.7 billion in deficit reduction through cuts in programmatic spending in FY 1988. This is consistent with our goal of a permanently lower level of Federal spending, gradually arrived at.

We are also recommending $22.4 billion in deficit reduction in FY 1988 through changes affecting receipts. Of this amount, about $13 billion represents proceeds from loan asset sales, privatization efforts, credit reform and proposals to strengthen the FSLIC. These proposals provide a variety of near term budget savings over the next few years. Unlike new taxes, these proposals do not represent a permanent revenue stream which would encourage growth of government and a larger Federal establishment. Indeed, they work in the opposite direction.

The asset sales and privatization initiatives are one-shot final sales of portfolios and assets which are better managed and better run by the private sector. Sale of these assets will reduce the intrusion of the Federal Government into the economy. (Of course, there will be ongoing tax revenues received from profitable privatized enterprises.) Credit reform, while a permanent program, would act to reveal unintended subsidies and de facto "grants" on questionable or defaulted loans. While saving money near term, it would act to slow the growth of such programs and reduce government involvement in credit allocation decisions better left to the market. FSLIC recapitalization mobilizes the future insurance fees charged to the S&L industry to hasten the resolution of problems facing a portion of the industry, saving money long term and speeding the day when FSLIC intervention will return to more normal levels.

While the remainder of the receipts changes do represent permanent revenue proposals, they have to do with equity or fees for services, which must be distinguished from a general tax increase. For example, the IRS initiative seeks to improve on the collection of taxes owed but not paid. The extension of the medicare HI tax to state and local workers will cover a group whose members often become eligible for medicare services as spouses of eligible retirees or through periods of covered earnings in other occupations. Customs user fees are obviously fees for service.

The reduced level of debt brought about by these programmatic and receipts proposals will result in a reduction in interest outlays of $1.3 billion in FY 1988, in addition to the savings listed above.

In brief, we feel that these proposals are an innovative solution to the problem of reducing the deficit without expanding the government, and that they enhance both equity and economic efficiency at the same time. They offer added budget savings in the short term to achieve the desired degree of deficit reduction while enabling us to approach longer term programmatic savings in a more orderly and gradual fashion. This will make it easier ultimately to accomplish more in the way of permanent deficit reduction via reduction in the size of government.

Receipts Proposals in the Budget

Asset Sales -- To preserve individual initiative and limit state interference, governments should restrict the type of goods and services they supply to those that are not provided by the private marketplace. In the past, the Federal Government has not always followed this policy and has acquired many commercial-type assets, real and financial, that in effect make the government a direct competitor of the private sector. In his FY 1987 Budget, the President proposed that we start selling off some of these assets. We have renewed this proposal in our FY 1988 Budget.

Asset sales have both positive and negative accounting effects on the budget, depending on the time perspective. In the short run the overall budget deficit will be reduced by the net amount received from the purchasers of the assets. Budget deficits in later years will increase, however, because the sale of an asset today means that the government will not receive in later years the expected stream of income from the sale of goods and services produced by the physical assets or the interest income and principal repayments on financial assets that it otherwise would have received.

A significant part of the asset sales recommended in the FY 1988 Budget are sales of loans. By selling a portion of its loan portfolio to private investors the government can reduce its expenses incurred in administering these loans. In addition, loan sales at market prices provide a measure of the subsidy provided to the borrowers. This subsidy can be compared with the social and economic benefits of the loan. And it provides the Executive Agencies and the Congress with the information necessary to compare the relative costs and benefits of the subsidized loans.

The FY 1988 Budget proposal for loan sales includes loans with a face value of $11.2 billion in 1988, producing net revenues of $5.3 billion.

In addition to its existing loan portfolio, the Federal Government currently provides new direct loans and loan guarantees through various credit programs. In keeping with the objective of not competing with the private sector, Federal credit programs should operate through the private markets and reveal their true costs. Toward this end, the President is proposing to change the way Federal credit programs are treated in the budget. These changes, which will provide revenues of $1.3 billion in FY 1988, will provide a measure of the value of subsidies granted under Federal credit programs, give the Administration and the Congress better analytic tools to evaluate the allocation of Federal resources among programs, and put direct loans and loan guarantees on the same footing as other full cost Federal expenditure programs.

User Fees -- The President's Budget continues to emphasize the importance of assuring that those who receive and benefit from special Federal services bear the cost of those services, rather than the general taxpayer. Instead of providing these services to special groups free of charge or below cost, those who benefit from special Federal services should be required to pay user fees or other charges that reflect the cost of providing these services. Accordingly, the Budget imposes additional fees and charges of $3.2 billion for such services as VA, FHA and GNMA home lending activities, Coast Guard services, recreation user fees, travel fees, and a new insurance fee on guaranteed student loans to cover the costs of loan defaults.

Privatization -- The Administration's strategy of shifting the production of goods and services from the public to the private sector is consistent with a policy of not competing with the private marketplace, reducing government spending, and maximizing economic efficiency. Budget proposals include the sale of ongoing businesses and productive assets to the private sector, reduction of legal barriers to competition, and contracting out for the provision of commercially-produced goods and services.

The FY 1988 Budget estimates include $5.4 billion of additional revenue from such privatization initiatives as divesting Amtrak; sale of the Naval Petroleum Reserves, and helium operations; and auctioning off licenses for the unassigned radio spectrum for non-mass media services.

Other enforcement and revenue initiatives -- The Budget includes several other enforcement and revenue initiatives that will increase FY 1988 receipts. These initiatives are limited to measures that will help collect taxes owed but not paid and that affect the financial condition of certain government trust funds.

In total, these revenue initiatives amount to $6.1 billion in FY 1988 and include such items as better IRS enforcement of the tax laws, extending the medicare hospital insurance payroll tax to state and local government employees, repealing exemptions from gasoline and other highway excise taxes, and broadening and extending beyond their expiration date certain Customs user fees.

Finally, another initiative to help reduce the budget deficit concerns the problem of our failing thrift institutions. A proposal to recapitalize the Federal Savings and Loan Insurance

Corporation was sent to the Congress last year. During the closing weeks of the last session of Congress, the House and Senate passed basically the same version of a bill addressing this problem, but compromise legislation was not sent to the President. The Treasury considers this very necessary legislation, and we hope the 100th Congress acts on it promptly. This proposal would raise $1.6 billion in FY 1988.

American Competitiveness

Today the United States faces new competitive challenges as a result of fundamental changes in the world economy. Many countries have emphasized scientific progress, technology transfer and improved productivity growth to strengthen the international competitiveness of their economies, and the United States needs to do more in these areas to maintain its economic strength and world leadership.

As promised in the State of the Union, President Reagan last week sent to the Hill a comprehensive package of measures designed to enhance our competitiveness. The President will also be making a direct personal effort to convey to the American people the importance of becoming more competitive and avoiding a lurch toward protectionism.

Concern for global competitiveness does not necessarily imply that we should look at policies that will artificially promote certain industries or sectors to reduce specific portions of our trade deficit. Such an approach suggests an industrial policy that could emphasize some industries that do not have a comparative advantage in trade at the expense of those that do, and could impede the efficient allocation of our resources.

Rather, there are several areas where Federal Government actions, in the context of a free market and limited public involvement, could increase overall U.S. productivity and improve U.S. competitiveness by promoting more efficient use of resources. These include encouragement of research and development, defense of intellectual property rights at home and in international negotiations, promotion of human capital development, and removal of legal barriers to the international competitiveness of U.S. industry in the areas of antitrust and product liability. The Administration has already taken a number of steps in these areas which we will continue to pursue in the next two years.

In addition, we propose several programmatic increases in the FY 1988 Budget. These proposals include increased funding for Federally supported basic research. The Budget would increase funding about 18 percent for basic research for the National Science Foundation, and double its research budget over the next 5 years; increase funding about 22 percent for basic research by NASA, including two new science and technology programs; and increase funding about 15 percent for the general science programs of the Department of Energy.

Basic research on an interdisciplinary basis often leads to creation of important new fields, such as biotechnology. For 1988, the Administration proposes to establish 5 to 10 new interdisciplinary science and technology centers through the National Science Foundation, modeled after NSF's existing engineering research centers, with participation by industry and the states to speed transfer of new knowledge from the laboratory to the marketplace. In addition, the Administration proposes to increase the emphasis on academic basic research programs in order to enhance the development of the nation's scientific and engineering human capital.

A substantial amount of non-classified technology and new knowledge is developed in Federal laboratories. However, its usefulness is limited if it is not made available to the private sector where it can contribute to creation of new products, new processes, new jobs and enhanced U.S. competitiveness. Using the Technology Transfer Act of 1986 and other authority, the Administration will increase efforts to transfer to the private sector results of Federally supported research and development through greater use of incentives for Federal scientists and engineers, exchange of scientists and engineers between government laboratories and industry, and cooperative research projects between industry and Federal laboratories.

The Administration's Budget also seeks to strengthen certain "leading edge" technologies. We propose to: initiate a new civil space technology effort to deploy the space station, develop the national aerospace plane, and foster commercial development of space; strengthen the Strategic Defense Initiative and associated Department of Defense initiatives involving strategic computing and very high speed integrated circuits; and support cooperative research and development ventures by the Department of Energy to encourage greater private sector participation in fossil, solar, and energy conservation research and development.

Efforts to promote human capital development are also important for improving productivity and competitiveness. Accordingly, the Budget includes funds to expand and improve training and job placement assistance for workers dislocated due to imports or other developments.

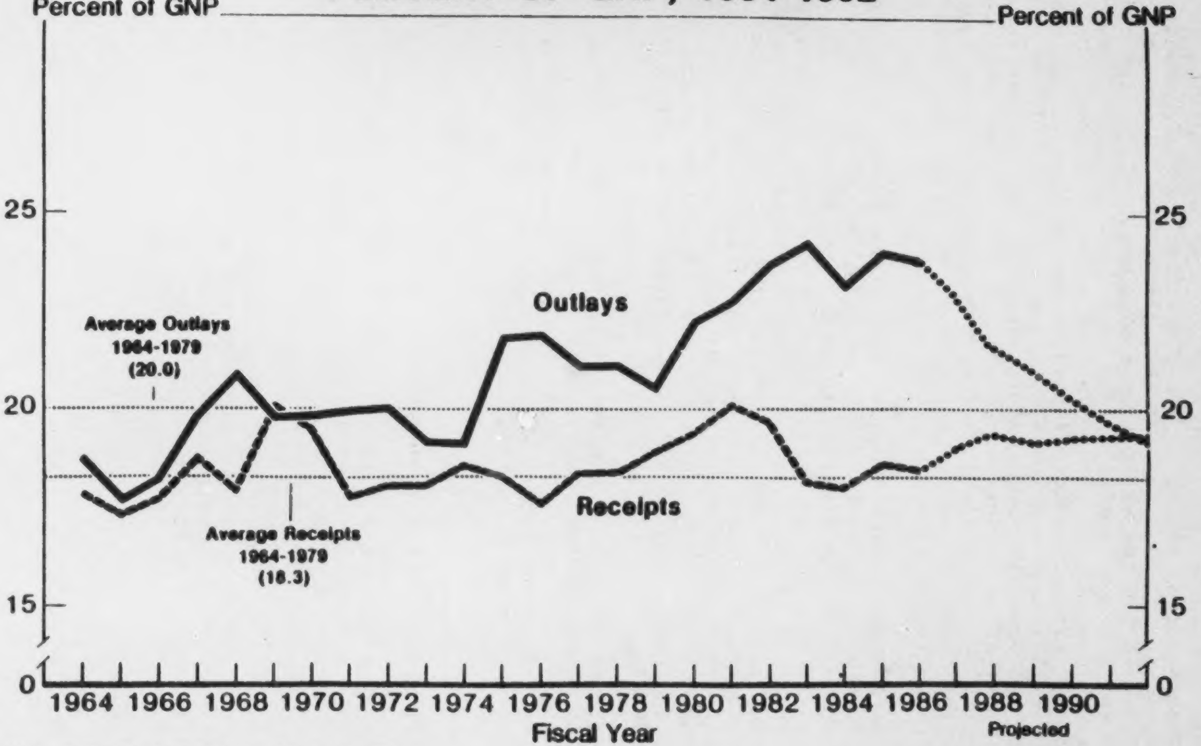
Conclusion

The President's Fiscal Year 1988 Budget can help prepare America for the future, while moving us well along the deficit reduction path. I recognize that any venture involving budget cutting will breed disagreements -- some very strongly held. But we must keep at it. Now that we've turned the corner, we can't slacken our efforts and our determination to reduce the deficit.

Congress has taken some difficult votes on expenditure cuts over these past years. We recognize and applaud those members, of both parties, who have acted courageously to better serve the nation's interest. We are hopeful their leadership will carry forward the momentum of deficit reduction.

Attachments

OUTLAYS AND RECEIPTS AS PERCENT OF GNP, 1964-1992



Note: Outlays include off-budget federal entities.

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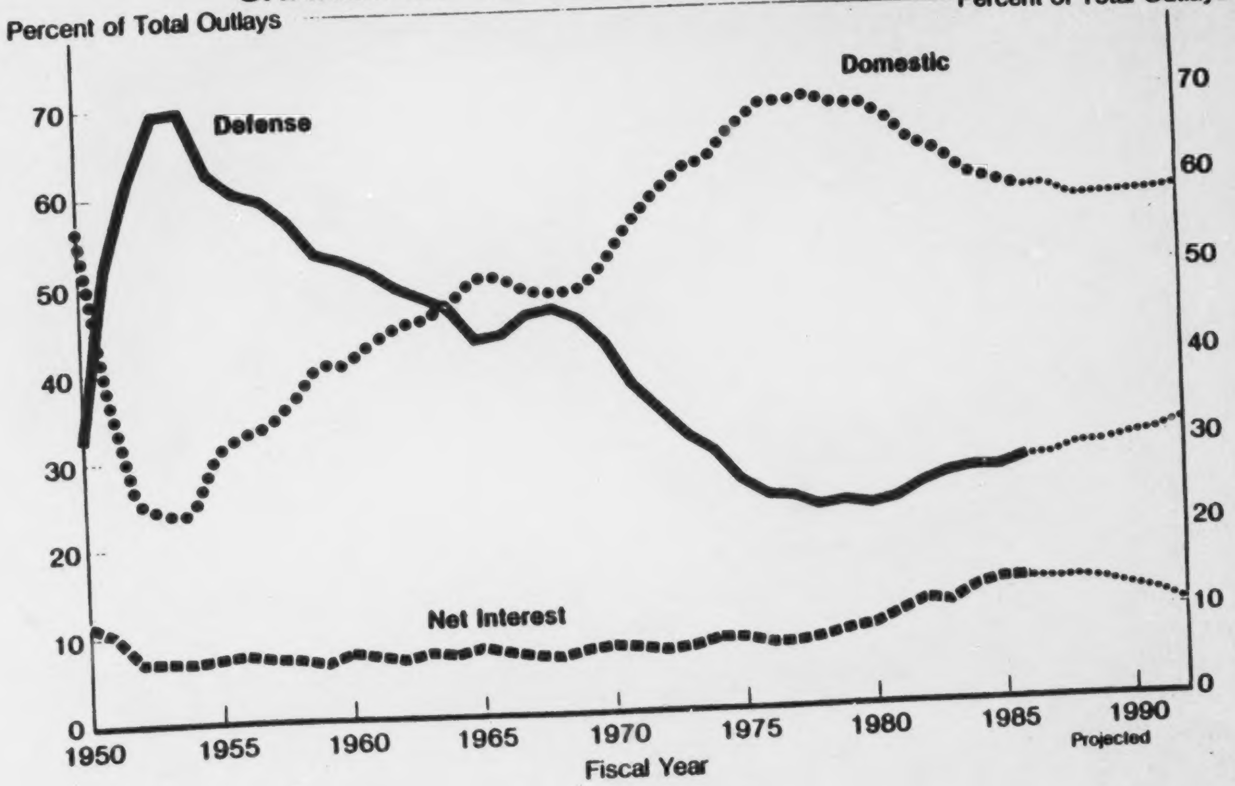
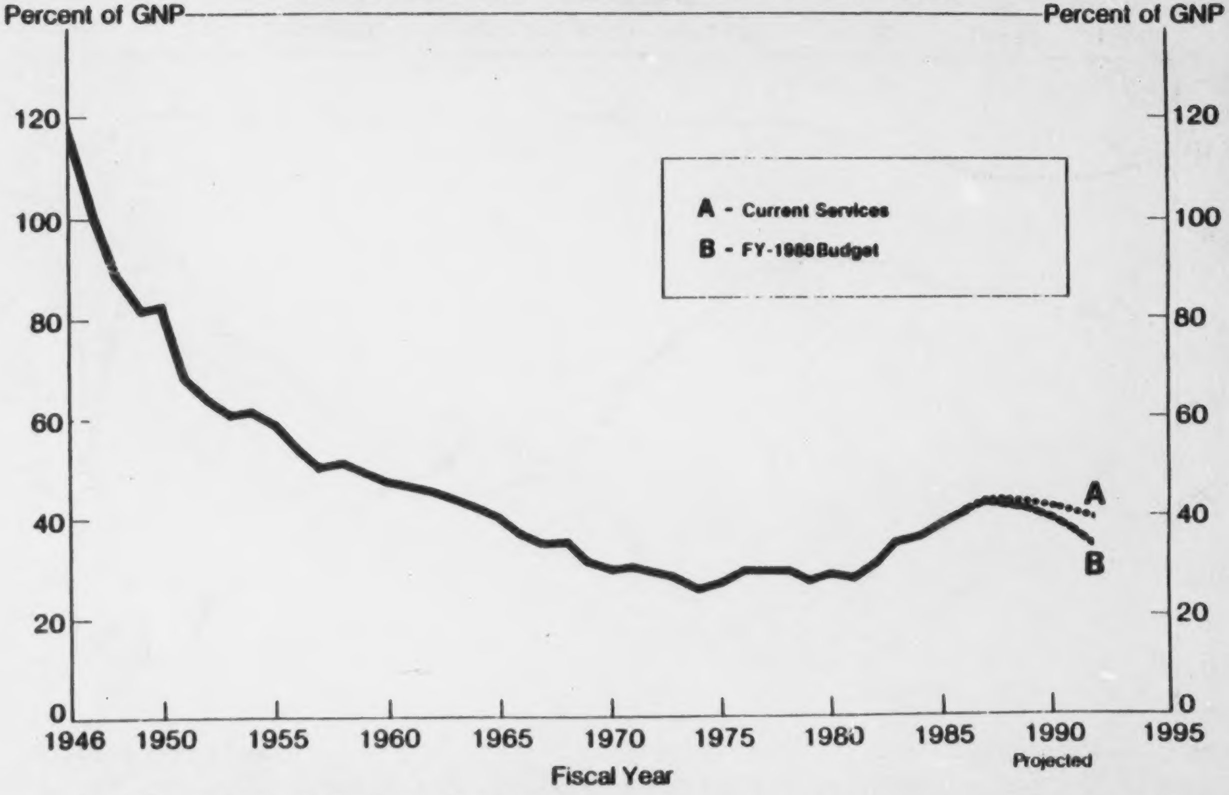
SHARES OF TOTAL BUDGET OUTLAYS



FEDERAL DEBT AS PERCENT OF GNP



Note: Debt held by the public, including the Federal Reserve.

January 2 1987 [illegible]

STEPS TO IMPROVE U.S. ECONOMIC PERFORMANCE

Secretary **Baker**. Mr. Chairman, during 1986, the United States took two historic steps that we think hold the promise of improving our economic performance for some years to come: First of all, the forces set in motion by the President in his State of the Union Address 3 years ago culminated last year in the Congress' enactment of a comprehensive reform of our tax system. This bipartisan effort created a fairer, more equitable tax system and one containing major incentives for increased economic progress.

Second, the Tokyo Economic Summit laid the foundation for sustained world economic growth by starting to provide procedures for improved coordination of economic policies among the seven leading industrial democracies. While the art of international economic policy coordination and cooperation is still developing, I think our preliminary successes have at least created an environment of opportunity.

The record for the year 1986 was generally favorable, although we do aspire, of course, for continued improvement. Let me briefly summarize.

SUCCESS IN U.S. ECONOMIC POLICY

First, the current economic expansion has extended now into its fifth year, and there is every prospect that the current expansion will continue unabated through 1987 and into the years beyond.

In 1986, consumer prices increased less than any year in more than two decades. For millions of elderly Americans who fear the erosion of hard-earned savings from inflation and the poor whose resources are stretched at the checkout counter, this affirmation of our earlier accomplishment is most welcome. Over the past 6 years, inflation has been cut drastically from the nearly 13 percent averaged in 1979 and 1980 to 4 percent or less for the last 5 years.

The number of people holding jobs increased by 2½ million during 1986 alone. Throughout the present expansion, the number of jobholders has risen by almost 12 million, lifting the percentage of the civilian population currently employed to 61.1 percent, a new record.

Interest rates continued to decline. The prime rate now is down 2 full percentage points from early January 1986. It is down two-thirds of what it was in early 1981. Currently, it is 7.5 percent, the lowest that it has been in over 9 years. Other rates, both short- and long-term, are down 1.5 percentage points from 1 year ago. This is particularly good news for young people striving to buy their first homes or refinancing high rate mortgages.

I would submit to you, Mr. Chairman, that this is solid, economic performance. Nevertheless, I would agree that we still have much work to do. The progress of 1986 should set the stage for an even better year for real economic growth and employment in 1987.

ECONOMIC FORECAST SUMMARY

To summarize our economic forecast, we expect real growth to average 3.25 percent across the four quarters of this year. This estimate is about in line with the private forecasters' consensus of growth close to 3 percent. It is a little faster than the roughly 2-percent average during the four quarters of 1986, but signs were emerging in the latter part of last year that the economy may be picking up some momentum. Statistics early this year have generally been encouraging.

We cannot, of course, expect inflation to remain as moderate in 1987 as it did in 1986, benefitting as its did in 1986 from the fall in the world oil prices. Still, there is no resurgence of inflation in prospect, and we expect the GNP deflator to increase by about 3.5 percent during the year, with consumer prices rising a shade more than that.

WORLD ECONOMY DEVELOPMENTS

Developments in the world economy should also help to further our objectives in 1987. We have, as you know, been working closely with the leadership of the major industrialized nations to improve economic policy coordination and to improve the global prospects for sustained noninflationary growth.

This past weekend in Paris, we took another step forward in our efforts to promote closer, more effective coordination of international economic policies. A number of our industrial allies committed with us to take action to achieve more balanced growth and a reduction of trade imbalances. These measures should foster greater stability exchange rates around their current levels.

We will continue to impress upon foreign industrial countries, particularly those with large surpluses, our mutual need for them to achieve stronger and more sustained growth. Because it is clearly time for our exporters to benefit from greater growth abroad, and from a more reasonably valued U.S. dollar, we really could not pick a worse time to unfurl a banner of protectionism in the United States.

DEBT PROBLEMS OF FOREIGN COUNTRIES

Our program for sustained growth for debt-burdened developing countries also is coming into place, enhancing prospects of renewed growth and development in these countries. The debt problems of these countries didn't arise overnight, and they won't be solved overnight. But the combination of market-oriented economic reforms, structural lending from the international financial institutions and commercial bank loans to help implement comprehensive adjustment is making a good start.

MULTILATERAL DEVELOPMENT BANKS

The growth-oriented reforms undertaken by the debtors are critical to the success of our debt initiative. They deserve, Mr. Chairman, our support, and the Multilateral Development Banks are a particularly important vehicle for promoting this. We and other member countries have succeeded in persuading the MDB's to advocate financing in support of these difficult but much-needed structural and sectoral reforms. The United States clearly has significant influence in the Multilateral Development Banks, but that influence will diminish if we are not able to fulfill our commitments to these institutions. Consequently, we feel it is essential that Congress support the U.S. contribution, which is reflected in this budget.

REDUCTION OF FEDERAL DEFICIT

Mr. Chairman, we have come a long way over the past 6 years. Still, there is a major item of unfinished business on the fiscal agenda, and, of course, I am referring to further reduction of the Federal budget deficit.

I think it is fair to say, though, that we have reached a turning point on the deficit. Measures already taken have pointed us in the direction of reduced deficits through spending restraint. Even if one assumes pessimistic economic forecasts, we have already put in place reforms that should lower the 1986 fiscal year deficit of $221 billion to roughly $175 billion in fiscal year 1987. That is about 5.3 percent of GNP to about 3.9 percent, with further reductions in the out-years.

Even this substantial reduction can and should be improved upon. The President's budget provides a plan for further substantial progress. If the proposals in this budget are adopted, the deficit would shrink substantially for the second consecutive year, and it would drop to about 2.3 percent of GNP in fiscal year 1988.

The deficit should be cut, Mr. Chairman, by reducing the scope of government spending rather than through tax rate increases. The American people are not undertaxed. Revenues as a share of GNP projected over the next 6 years are about 1 full percentage point above the historical average for the period 1964 to 1979. In contrast, the outlay share of GNP in the past 2 fiscal years was about 4 percentage points above the historical average.

We have approached deficit reduction in this budget on a somewhat different basis this year. There is less reliance on programmatic reductions, and we are not relying as heavily on spending cuts previously submitted and rejected by the Congress.

We are proposing $18.7 billion in deficit reduction on the spending side in fiscal 1988. But we are also recommending $22.4 billion in deficit reduction in fiscal 1988 through changes which affect receipts. Of this amount, about $13 billion represents proceeds from loan asset sales, privatization efforts, credit reform, and proposals to strengthen the FSLIC. Unlike new taxes, these proposals do not represent a permanent revenue stream, which would encourage the growth of government and which would encourage and support a larger Federal establishment.

While the remainder of the receipt changes do represent permanent revenue proposals, they have to do with initiatives to collect taxes owed or fees for services. These revenue measures should be distinguished, we think, from a general tax increase that could be used to support additional spending.

COMPETITION FROM FOREIGN MARKETS

Mr. Chairman, I would like to discuss one final area. Today, the United States faces new competitive challenges as a result of fundamental changes in the world economy.

As promised in the state of the Union, President Reagan last week sent to the Hill a comprehensive package of measures which are designed to enhance our economic capabilities.

ENHANCING U.S. ECONOMIC CAPABILITIES

The administration will continue to promote a more efficient use of resources that can improve our competitiveness. We should defend intellectual property rights at home and in international negotiations and remove legal barriers to the international competitiveness of U.S. industry in the areas of antitrust and product liability.

In addition, the administration's budget seeks to strengthen certain "leading edge" technologies by fostering the commercial development of space and strengthening military programs involving strategic computing and very high-speed integrated circuits.

Efforts to promote human capital development are also important for improving productivity and competitiveness. Accordingly, the budget includes funds to expand and improve training and job placement assistance for workers dislocated due to imports or to other developments.

Fundamental to good government is the ability to set priorities. This budget shows that eliminating the deficit is possible without raising taxes, without sacrificing our defense preparedness and without cutting into the safety net for the poor and the elderly.

Other programs basic to our national interest also should be properly funded. Some, like basic scientific research in the space program, will help keep America strong as we prepare for the 21st century. Others, like drug enforcement, AIDS research, and reduction of infant mortality, will safeguard the soul of America, her people.

This budget can help prepare America for the future while moving us well along the deficit reduction path. Mr. Chairman, I recognize that any venture involving budget cutting will breed disagreements, some very, very strongly held.

But we have got to keep at it. Now that we have turned the corner, we simply must not slacken up. The Congress has taken some very difficult votes on expenditure cuts over these past years, and we recognize and applaud those Members of both parties who have acted courageously to better serve the Nation's interests. We are hopeful, Mr. Chairman, that their leadership will carry forward the momentum of deficit reduction.

I would be delighted to respond to your questions.

FURTHER DECLINE IN U.S. DOLLAR

Chairman STENNIS. Mr. Secretary, each member of this committee will have a chance to ask you questions. I am going to be fairly brief. I have been concerned, on the growth of the foreign trade deficit. I know that the agricultural interests throughout the Nation has benefited by the situation we had with reference to our world trade. I know all of a sudden here we are losing the position of advantage there and very rapidly, very rapidly have started to forming these yearly deficits in world trade.

Earlier this month, the Federal Reserve Board Chairman, Paul Volcker, indicated to the Joint Economic Committee that he would not support any future efforts to push the dollar lower to reduce the U.S. trade deficit. Rather, he recommended that Congress reduce the deficit and try to persuade our trading partners, particularly Japan and West Germany, to take further steps to improve their domestic economic growth.

You indicated in your statement that you and Chairman Volcker agree that it would be beneficial to, and as you put it, "impress upon foreign industrial countries our mutual need for them to achieve strong, sustained growth."

You have also advocated reducing the deficit. Mr. Secretary, do you advocate a further decline in the U.S. dollar abroad in order to reduce our trade deficit?

Secretary BAKER. Mr. Chairman, we have just returned from a meeting of six of the major industrialized countries of the world in Paris over the weekend, and at that meeting, it was agreed that some of those countries that have substantial surpluses would take additional actions in order to deal with those surpluses by generating more growth so that they could absorb more imports.

We committed to continue to fight protectionism in this country. We committed to continue to fight to reduce our deficit on the spending side. Against that background and in light of those commitments, the six countries there agreed that these actions should foster a greater stability of exchange rates around their current levels.

We anticipate that that will be the case.

Chairman STENNIS. How long do you think it will take to make that proposition come around and take effect as you just stated?

Secretary BAKER. Mr. Chairman, we have seen, as you know, a substantial decline in the dollar over the course of the past 2 years. Against the Japanese yen, it has declined, I think it is something in the neighborhood of 40 or 41 percent. Against the German mark, it is something like 45 to 47 percent. The exchange rate changes take a long time to be translated into the trade figures.

The economists tell us that there is a so-called J curve effect, which means you have to wait 12 to 18 months to see those changes reflected in the trade figures. I must say that over the past 6 months, it would appear that our trade deficit is at least leveling off. The numbers are not getting any worse. The problem is not being exacerbated, if I can state it that way.

We have not as yet seen a downturn, but we are projecting, at the Treasury Department, a reduction of something in the neighborhood of $20 billion in 1987 in the trade deficit.

But I must say the exchange rate changes take a long time to be translated into trade figures, and we have said from the beginning of this exercise dating back to our meeting at the Plaza Hotel in September 1985, that we should not expect to cure the trade deficit on the exchange rate side alone. We have got to look at other policy tools as well, and one of those is reduction of the Federal fiscal deficit.

I don't think that I am prepared to quantify the exact relationship between the trade deficit and the fiscal deficit, and economists will disagree about it, but I do think that there is some relationship. That is why reducing the fiscal deficit from the spending side is one of the six elements of the President's competitiveness initiative.

CONCERN OVER U.S. TRADE DEFICIT

Chairman STENNIS. As I understand the situation now, there is concern, very deep concern about the decline in the trade deficit.

That, naturally, affects the outcome of the votes on various matters, direct votes and related votes that come about. I am not trying to accuse you of any neglect; the very opposite. I don't think you could do a better day's work in continuing to press this matter in every possible way that you can. You can't bring the fruit in right away. If you lay the groundwork, why, you will be doing it good just the same.

Secretary BAKER. Mr. Chairman, could I volunteer something?

Chairman STENNIS. Certainly.

Secretary BAKER. Let me simply say that it is our view that the trade deficit has got to be addressed in a comprehensive way, and it goes beyond simple changes in the trade laws, although that is a part of what we should be considering. But we should also be considering a better international economic policy environment; we should be trying to deal with the problems of Third World debt; we should be looking at a level playing field for U.S. businesses and industries on exchange rates, a topic which I have already addressed.

We need to take a look at the human capital side of this problem in terms of job training for dislocated workers and worker adjustment assistance. We need to take a look at revising some of our antiquated laws that make it very difficult for American businesses to compete: Antitrust laws, the Foreign Corrupt Practices Act, product liability. These things put substantial burdens on U.S. businesses, though I am not suggesting we should eliminate the Foreign Corrupt Practices Act. I am saying we ought to take a look at some changes, though, in terms of standards and burden of proof.

So there is a whole wide range of things that we need to be doing in addition to simply calling for some reasonable and responsible changes in our trade laws.

VALUE OF U.S. DOLLAR

Chairman STENNIS. The U.S. dollar has dropped 20 percent since last spring, a year ago. Now I am really asking for the value of your judgment on this matter. How has that affected our budget deficit and the U.S. trade deficit? You have touched on that some, but can you make the point on this?

Secretary BAKER. I have already said that I think we have begun to see some effect on the trade deficit. That is, a leveling off of that deficit. It is no longer increasing month-to-month the way it was. I think that you will see more of a beneficial effect as we move further and further down the line from the date on which most of that decline in the dollar began, which is September 1985.

We are about 16 months away from the agreement that we forged in the Plaza Hotel in September 1985. Two-thirds of the depreciation of the dollar against these other currencies has taken place since that Plaza meeting. It just takes a long time for the dollar's decline to have an impact, and because of the J curve effect, as the dollar continues to decline, it pushes further and further into the future the beneficial effect of coming around the curve to where the trade deficit tends to diminish.

Again, I would say that we look for a reduction in the neighborhood of $20 billion in the trade deficit in 1987.

Chairman STENNIS. Have you testified before the Finance Committee?

Secretary BAKER. I have testified before both the Senate Finance and House Ways and Means Committees on the issue of competitiveness in general, Mr. Chairman, exchange rates, trade law changes, what we should do in the area of deregulation, the things that I have just talked about here this morning.

Chairman STENNIS. I thank you very much. I may have some more questions I will ask later.

I want to call on the Senator from Oregon now.

ON-TARGET PROSPECTS OF ADMINISTRATION BUDGET

Senator HATFIELD. Mr. Secretary, my first question: Will we have the pleasure of working with you in the foreseeable future in your capacity as Secretary of the Treasury?

Secretary BAKER. I hope so. [Laughter.]

Senator HATFIELD. At least in that seat.

Mr. Secretary, on page 9 of your testimony, you make the statement that, "We are submitting a budget that hits this target, $108 billion, for fiscal year 1988 without raising taxes."

I need not remind you that there is widespread skepticism as to whether the administration's budget really does meet this target. In fact, the CBO, as you know, at our request, has made an analysis of the President's budget just this last week, and by their analysis, they find that the President's budget misses that target by about $26.4 billion.

Recognizing that, subject to discussion, debate or argument, at least we also know that the President's budget for fiscal year 1988 fails by some distance to meet the out-year targets. While recognizing that there is a difference of interpretation of the law as to whether you have the responsibility to meet out-year targets of Gramm-Rudman-Hollings it is clear that this budget fails to meet the out-year Gramm-Rudman-Hollings deficit targets.

Mr. Secretary, let's play out a scenario here that I think probably has more realism than maybe we would like to admit, that the $108 billion target figure is not achievable under the President's budget or under the events that will occur now that the President has submitted his budget.

Will the administration work with the Congress in providing for other recommendations for reductions of spending, or will the administration tenaciously hang to the assumptions and the interpretations of the budget that it has submitted?

Secretary BAKER. Senator Hatfield, you know that every year we work with Congress throughout the budget process to see if we can't come up with a resolution that is satisfactory to both the legislative and executive branches, and clearly, we will do that again this year.

OUT-YEAR TARGETS

Could I make one comment on missing the out-year targets? We do miss them, but we don't miss them by much. I just would like to get that in the record. I think the greatest is about four-tenths of 1 percent of GNP, and that is in 1990 or something like that.

The difference between us and CBO is as follows. If you take the $8 billion out as represented by the fact that we are asking for 3 percent real increase in Defense and CBO is talking about leaving it level, we have a $19 billion difference between us. Ten billion of that, as you well know—but I just would like to get it in the record—has to do with our different growth assumption for 1988. We project 1988 real growth at 3.7 percent (fourth quarter to fourth quarter) and CBO projects it at 2.9 percent. Interestingly enough, the consensus of the Blue Chip forecast is right smack dab in the middle of that, 3.3 percent.

I think there is plenty of room for reasonable minds to differ about whether CBO's estimate is better or whether OMB's estimate is better. But the point is that our estimate is not out of the ball park. I think that it is really not totally accurate to just say categorically, "Your budget misses the 1988 Gramm-Rudman-Hollings target by $27 billion."

We really think ours makes it, and those differences are understandable, that I have just alluded to.

ACHIEVABILITY OF GRH TARGET

Senator HATFIELD. Again, I won't engage in long dialog this morning, because I think there are a lot of assumptions that we could really isolate and debate on at some length. But the Wall Street Journal, on Tuesday, the 24th, was quoting Mr. Miller. That is the Director of the Office of Management and Budget. And I am attributing this purely to this story. I have not talked directly to Mr. Miller about this.

Following the Chairmen's statements of the House Budget Committee and the Senate Budget Committee, that the Gramm-Rudman-Hollings target of $108 billion would not be achievable or could not be achievable without the possibility of hurting the economy—and I would like to have you comment on that possibility, too, of perhaps causing a recession—and therefore, that perhaps a reduction of around $40 billion in the deficit this year is all we should do with the assumption that the deficit will be about $170 billion and getting the deficit down to about $130 as against the target of $108 billion.

The story says that, "James Miller told reporters that a budget package that reduced the deficit by about $42 billion would be satisfactory." In fact, I think they have quotation marks around that statement.

The question is a two-part question. One is: Would that be a satisfactory target, a modified target from Gramm-Rudman-Hollings not withstanding the legal implications?

Second, if we insisted on reaching the target figure set by Gramm-Rudman-Hollings, what are the merits and what are the perils of achieving that figure as it affects our economy?

Secretary BAKER. Senator Hatfield, I think, frankly, that achieving a Gramm-Rudman-Hollings target of $108 would be beneficial to our economy, not detrimental, if it was done on the spending side—if we don't come along and hammer the economy with a general tax increase.

As I mentioned earlier, we have got $22 billion of revenues in this budget. We can argue about whether we like them, whether that is the right form, and all the rest, but they are revenues, and most of our deficit reduction is in the form of revenues this year.

So No. 1, I would think it would be beneficial to the economy if we could hit the target. I know this: It would certainly be beneficial in terms of our efforts in the international economic arena—trying to resolve these imbalances on the trade front—if we could do that.

Second, to answer your first question, I think a $42 billion reduction would be welcomed by the administration, again, provided it wasn't done through the mechanism of delaying the tax-reform reduction in marginal rates or a general tax increase or something like that. It would be extremely good, but it should not be characterized as a $42 billion reduction which modifies the Gramm-Rudman-Hollings targets.

We are asking for $42 billion. The only thing that needs to be done is for someone to convince the Congressional Budget Office that our projections are, indeed, reasonable. When you compare them with the Blue Chip consensus forecast, they are reasonable. Then, a $42 billion deficit reduction package will get you to $108 billion or at least darn close to it.

IMPORTANCE OF $42 BILLION DEFICIT REDUCTION

Senator HATFIELD. Do I hear you saying that the reduction of $42 billion, whether it reached the $108 billion target or whether it reached some other target, that is more important than aiming only at the figure $108 billion?

Secretary BAKER. What the administration would be disinclined to do, Senator, is to abandon that target, because the minute we start talking about doing so, we lose discipline, if you will, all of us, the executive and the legislative branch, as well.

This is a law the Congress passed; it is a law the President signed. We feel honestly, in good faith, we have kept our part of the Gramm-

Rudman-Hollings bargain by submitting a budget on time that meets that target.

A $42 billion reduction, particularly if it is done in the manner in which we have suggested in our budget, that is, from the spending side, would be a very healthy thing for this economy, without getting into the argument about whether or not it meets the target. We think it would meet the target.

DEFICIT REDUCTION ASSUMPTIONS

Senator HATFIELD. Mr. Secretary, really what I think I hear you saying is, in other words, change the assumptions and presto, we have hit the target?

Secretary BAKER. No. We think our assumptions are reasonable, and that we are not coming up here——

Senator HATFIELD. What is your track record on those assumptions?

Secretary BAKER. Pardon me?

Senator HATFIELD. What is your track record?

Secretary BAKER. They are not bad at all. We have got a 40 percent success ratio. It is about the same as private forecasters would expect to achieve and, really, about as good as CBO, if I might say so. There is not much difference between us here. It all revolves around the growth figure for 1988.

So what I am really saying is, let's do $42 billion.

DEFICIT TARGET AND MILITARY SPENDING

Senator HATFIELD. What happens if these assumptions—and we have had this happen in the past—where the assumptions prove too optimistic before we get into the final actions of the appropriations process, and let's assume that we are trying to reach the target figure of $108 billion without disturbing the in-place tax program. In other words, we are not talking now about new taxes or additional revenue enhancement, and we are not really going to do very much to modify any changes in entitlements.

So we come down to the non-defense discretionary spending part of the program where the emphasis on this target figure and the deficit reduction has been placed. Let's say that that is not achievable under changes in the forecast that have proven too optimistic.

We are faced with the question of either reaching that $108 billion figure or reducing the level growth in military spending.

What are the priorities under that scenario between the $108 figure target and the reduction of real growth on the military spending side? What is the priority in those two circumstances, those alternatives?

Secretary BAKER. I don't think that the administration would choose on an either/or basis between those, Senator, because we think and honestly believe that we have met both, that we have submitted a budget here that would permit the 3 percent real growth of defense spending that the country requires to meet its national security needs and at the same time hits the $108 billion target.

Let me say one final thing on the rosy scenario question and your question about track record. We have been right 40 percent of the time; wrong 60. I think we have been right in 2 years and wrong in 3. With economic forecasting, that is not all bad. When I say we have been right, we have been high in the 2 years in which we have been right; growth was a lot more than we forecast. In three of those years, it was less. That is why I say when we come in here with 3.7 percent growth for 1988 and CBO has 2.9 percent and the Blue Chip consensus is smack dab in the middle of it, I think our forecast is reasonable.

Senator HATFIELD. I know, but again, I have developed a scenario on the basis that we are talking February 1987. This process will not wind up before August 1987. The track record that you talk about, I suppose, in that realm of fortune telling and palm reading is a pretty good track record.

But by the same token, there is sufficient leeway there in that track record that we could be wrong on these assumptions by the time we get to August. What I am trying to really determine is your set of priorities, because you said you opt for the $108 billion target even over and against some of the views that that might be hurtful to the economy and we should settle, perhaps, for $42 billion.

Let's project that back again to the priority as between reaching that $108 billion objective at the expense of having to reduce military spending by a half percent, 1 percent, something under the 3 percent.

Secretary BAKER. Would we have made the discretionary domestic spending cuts called for in the President's budget?

Senator HATFIELD. We have made all those cuts.

Secretary BAKER. Would we have made the loan assets sales called for in the President's budget?

Senator HATFIELD. No, that is not going to happen under any circumstances.

Secretary BAKER. None of them?

Senator HATFIELD. I don't say none of them, but I am saying when you talk about PMA's, you know the record of this Congress on that.

Secretary BAKER. You are talking about that? I was thinking more in terms of the paper we are holding in the Federal Financing Bank.

Senator HATFIELD. Let us say we have met the majority of those recommendations.

Secretary BAKER. That is a bridge that we would have to cross when we got to it, Senator Hatfield. As you know, I mentioned that I think we have turned the corner on deficit reduction. I think we are going to see, under a pessimistic performance, even if you assume a pessimistic performance, which we don't anticipate happening, you will see a substantial deficit reduction in 1987, down from $221 billion to $175 billion. A lot of that comes, as you know, from reductions that have been legislated in Defense expenditures.

So the question that you put to me is one that is not for me to answer. If and when we got to that point, that would be a question that the President would have to answer. But I can tell you this: I know full well what his thinking is. It is his view that we have cut Defense too much already.

Senator HATFIELD. I understand.

Mr. Chairman, I have overspent my 10 minutes. I am sorry about that.

But we will be following up with you, Mr. Secretary. It is always a delightful experience to have you appear before our committee. Thank you.

Chairman STENNIS. Senator D'Amato, that brings us to you.

Senator D'AMATO. Thank you, Mr. Chairman.

REDUCTION OF FUNDING FOR WAR ON DRUGS

It is always good to see the Secretary. I won't say publicly what I said to you privately, Mr. Secretary. It was complimentary in one respect and rather pointed in another. We would have avoided a lot of problems had we kept the Secretary where he was, as the Chief of Staff.

But having said that, Mr. Secretary, I am very much concerned with respect to the budget proposal. I am not going to talk about whether various areas of the revenue estimates may be higher than what we can reasonably anticipate.

I look at what I believe is a retreat from the promises that we made to the American people when we passed the antidrug abuse bill last year. This is especially true of the budget submitted by the Customs Service. I am concerned that the budgets of several of the Treasury Department agencies are unrealistic, and I would like to pursue that with you, if not in detail now, at least to the extent that you would review some of the questions I will submit to you in writing, and personally review the situation with respect to the air interdiction program.

What we appear to see is on-again/off-again. First, we have an attempt to delay the spending of some of these moneys until next year. Congress, I believe, Mr. Secretary, has made it very clear that we want to proceed with this program this year. This kind of tactic, dilatory at best, becomes rather disruptive.

So I am concerned about that. I am concerned, and I would ask you to make a reply to this aspect, about the proposed reduction in the number of personnel, and a 12-percent reduction, or $120 million, in budget authority. That is almost 2,000 Customs positions. It is nice to say that computers and new techniques are going to give us the ability to check out the cargo in the Customs, but Mr. Secretary, aren't you concerned, as I am concerned, about the effect on the law enforcement program that this kind of curtailment of basic services and 2,000 personnel will have?

I don't know if you want to respond to that, but I tell you that this is something that I share with a number of my colleagues, and we are rather frustrated at what I would perceive to be OMB's and others' insensitivity to these concerns.

Secretary BAKER. Senator, I think, hope and believe that Senator DeConcini, who, as you know, is extremely interested in this area and is the subcommittee chairman, would agree with my characterization of my effort as being all-out in support of our role in the war against drugs and all-out in support of the Customs Service. In that regard I must say this: I think that there is a reasonable answer to your concern about the delay in spending some of the funds for the air program. We are really only talking about $32 million. It is not a question of whether the funds will be spent. They will be spent. But the timing of the expenditures is the only issue. It is due to different technical assumptions about the costing out of these projects. There is no intention whatsoever not to spend these funds. They will be spent.

Senator D'AMATO. We are not talking about next year, now. I have a budget request that comes from Treasury that talks about deferring these dollars over to 1988.

Secretary BAKER. Deferring $32 million of $171 million for actual expenditure in fiscal 1988.

Senator D'AMATO. Are you still pursuing that? We get mixed signals.

Secretary BAKER. No, sir. We have a supplemental, but we have a request in a supplemental appropriation that is coming up here to delay the availability for obligation until fiscal 1988. If the Congress doesn't agree with that, we will have to find some way to obligate even if it is not the most efficient thing to do at the time, in fiscal 1987.

Senator D'AMATO. When will that request come?

Secretary BAKER. As far as I know it is already up here. Hang on a minute.

[Discussion held off the record.]

Secretary BAKER. It is up here.

Senator D'AMATO. What will it take for you to understand that we will not do that?

Secretary BAKER. If you don't enact the language, then we will understand that you——

Senator D'AMATO. How long? What would be reasonable? This can become a technique by which to avoid the spending of money. What would be a reasonable time that you would anticipate that we would need to take affirmative action on your request? Or when would you get the message that we don't agree with you?

Secretary BAKER. I would have to discuss that, I guess, with OMB, but in terms of the operational end of this thing, it is our view that these funds are better spent if we don't have to rush out here and spend them before September.

Senator D'AMATO. OK.

Secretary BAKER. But if up here you say, "No, we are not going to agree with that," then, of course, we will have to find a way to spend them in fiscal 1987. Remember, we are spending $140 million of the $170 right now.

FUNDING FOR DRUG INTERDICTION

Senator D'Amato. Let me be candid. OMB doesn't have a good track record with us. As I review this budget, and you know the esteem that I hold you in, I have to tell you that this is a budget that absolutely does incredible violence to not only Customs and its ability with respect to interdiction of drugs, but also to all of the other day-to-day activities that are rather important, and it does it in several other areas of law enforcement.

I am not going to be more specific out of respect for yourself, but there is no way that we can say we are serious when we are making a 12-percent cut, or a cut of $120 million. There is no way that we can say we are really serious when we set up user fee funds and then defer the use of them to 1988. I see this repeatedly. This is what is taking place. And it gives rise to this Senator's anxiety that there are some who talk about the war on drugs but then who defer the dollars, put them over for another time, whether it be for air interdiction or whether it be in terms of the personnel that is necessary to really carry on this important struggle.

By the way, it is only holding the dike. It is not going to win the battle. But when you begin to make these kinds of cuts, the Customs Service is important in that connection, and that is why I am very much concerned, Mr. Secretary.

Secretary Baker. Senator, I understand what you are saying. Expenditures, particularly as far as outlays are concerned, are going to be up considerably from what they were last year for the Customs Service. We are going to have, or we do have a reduction from $171 million to $86 million in the air program. That is as a consequence of not having to go out and buy capital, buy airplanes, like we asked you.

CUSTOMS FORFEITURE FUND

Senator D'Amato. Let me give you, Mr. Secretary, just one other example. The Customs Forfeiture Fund. When the budget cuts this fund by 44 percent from $18 million to $10 million, what does OMB say? It says that this reflects, "—the non-recurring cost of the fiscal 1987 drug interdiction effort."

Now, there is nothing nonrecurring about the purpose for which the Customs Forfeiture Fund is used. This isn't a situation where you go out and buy a piece of equipment so you are not going to have to do it again. It is that kind of situation that we see. We see actions to thwart the use of these dollars.

Again, these are serious matters. We are very much concerned about it. I propose to submit some questions to you, and I would like to sit down and take some of your time to see to it that we really coordinate these efforts. We should not be adversarial. I think we both perceive this to be a most pressing and crucial problem.

Secretary Baker. Absolutely.

Senator D'Amato. Thank you, Mr. Chairman, and thank you, Mr. Secretary.

Chairman STENNIS. Thank you, Senator.

Senator Reid, that brings us to to you, sir.

Senator REID. Thank you very much, Mr. Chairman.

SERVICE-ORIENTED NATURE OF AMERICAN ECONOMY

Mr. Secretary, give me your opinion as to why the American economy has become increasingly more service oriented and why many sectors of our industrial economy are no longer competitive?

Secretary BAKER. It has become more service oriented, Senator, because the American economy has always been the most efficient economy in the world from the standpoint of flexibility. That is good. There is nothing bad about that.

There is nothing bad about the fact that we created, since the end of the recession, over 11½ million new jobs, many of them in the service sector. The service sector includes some high technology efforts, such as computer programming, and a wide range of things in the information field.

So the idea that somehow, it is bad that our service sector is growing so much is not something we subscribe to.

Senator REID. Mr. Secretary, I don't think anyone here doubts your commitment to deficit reduction, but there is some question as to the means that the administration has tried to employ over the last few years to reduce this deficit.

You insist—and you have indicated here again today—on cutting programs to reduce spending and the size of government. Taxes dedicated to deficit reduction have clearly not been an option that you have considered. You may be right.

My question is: In order to meet the liabilities the administration and this Congress has engaged, how do you justify borrowing being better than taxes? In effect, aren't they both taking money from the private sector? I guess the main difference is through borrowing, we pass it on and we don't have to bother with it now.

Secretary BAKER. Neither are preferred routes, Senator. The preferred route is to restrain the temptation and the impetus for ever-increasing spending. As I indicated in my statement, we are spending at the rate of 24 percent of GNP. Historically, that is way above where we have normally been. We have normally been at 21, and we are taxing at 19 percent of GNP, which is roughly where we had been historically.

What we really need to do is restrain our appetite for spending so that we don't have to borrow, but we will not restrain that appetite if we succumb to the temptation of tax. It is much easier to tax than it is to eliminate spending.

IMPORTANCE OF THE DEFICIT

Senator REID. You have indicated in your written statement, not when you summarized your statement, but in your written statement you talked about the economy, the good parts of the economy. But about this deficit, don't you agree with Volcker that the deficit is a problem that is No. 1 as far as the economy is concerned?

Secretary BAKER. I have agreed with that for a number of years, and my oral statement says such, that there is one thing, two things, really, we still need to really work on. One is the trade deficit; the other is the fiscal deficit, and they are somehow related.

Senator REID. The problem, though, that we see or that I see is the fact that we have a deficit that has been increasing. Last year, because of Gramm-Rudman, we were able to not increase it as much as people had anticipated.

FUTURE RETIREMENT OF THE PUBLIC DEBT

Do you see anything in the future that we could do to ever start retiring the debt?

Secretary BAKER. I don't think it is——

Senator REID. As I understand it, Mr. Secretary, the third highest item we have is interest on the debt, which is $210 billion now or something like that.

Secretary BAKER. I don't think, Senator, that it is entirely beyond the realm of possibility. I will say this: I think some of the spending cuts that have been accomplished in past years would never have taken place if we had succumbed to the temptation to raise taxes. Without disputing what Senator Hatfield just said a moment ago about the PMA's, I do believe there are some things that we could afford to do without in the Federal establishment. There are some things that we don't really have any business trying to operate as a Federal Government.

We really ought not to be in the oil business, and I don't think we ought to run railroads and airports, and I don't think we ought to be in the banking business to the extent we are in the Federal Financing Bank.

It is not going to hurt us. It is, in fact, going to help us, if we sell some of those assets, not talking about the Bonneville Power Administration.

Senator REID. But it really doesn't help the deficit except for just one shot.

Secretary BAKER. That is correct. But that doesn't mean you can't do it again next year, Senator.

Senator REID. What is there to sell next year?

Secretary BAKER. There are plenty of Federal assets that we can look at. We have got $155 billion of paper in the Federal Financing Bank, and we are asking you to sell $11 billion, phase them out, to generate $5 billion in receipts. We have got $155 billion of that stuff.

Senator REID. Do you think that it is a saleable item?

Secretary BAKER. Well, we sure ought to give it a try before we step out here and say we have to raise taxes. I think it is saleable, and we are willing to take on the first $11 billion.

EFFECT OF SOUTH AMERICAN DEFAULT

Senator **Reid**. Let me ask you one last question, changing the direction a little bit. We have heard accounts this week that at least two South American countries have announced that they are not going to pay their debt, interest on the debt, at least, which means they are not paying the debts.

What effect does that have on our economy, if any?

Secretary **Baker**. I don't know that we have heard it from two. We have heard it from Brazil.

Senator **Reid**. It is my understanding that another country, I heard on the news this morning, Paraguay or one of them. It might not be the right country.

Secretary **Baker**. Well, I am only aware of Brazil.

Senator **Reid**. I am sure you would know. Let's say other countries do, though, follow the lead of Brazil. What does that do to our economy?

Secretary **Baker**. I don't think that assumption is warranted under the circumstances. It is my view that what Brazil has done is unfortunate, but they will work this out in the context of negotiations with their private creditors. They are current with their official creditors and in the statement they say they will remain current with them.

If the hypothesis that you suggested came to pass, that is, that you had a whole bunch of countries defaulting on their debt, it could have adverse consequences.

Senator **Reid**. Tell me what would happen.

Secretary **Baker**. You would see some adverse consequences for some number of U.S. companies' profits.

Senator **Reid**. Thank you, Mr. Chairman.

Chairman **Stennis**. Gentlemen, that brings us to Senator Kasten.

ECONOMIC IMPACT OF $108 BILLION DEFICIT TARGET

Senator **Kasten**. Mr. Chairman, thank you.

Mr. Secretary, welcome. You made some comments earlier about the $108 billion deficit target, and we have been wrestling with that back and forth in the Budget Committee, as well, and now the chairman of the House Budget Committee has said that not only is the target unreachable, but reaching the target would cause an economic—I don't think ~~he said~~ a catastrophe, but reaching the $108 billion target, the chairman of the House Budget Committee said, would cause economic harm.

Would you respond to that?

Secretary **Baker**. I earlier said, Senator Kasten, that I think that it would be beneficial for our economy if we could reach the $108 billion target. We can't have it both ways, you know. We can't sit around here and talk about the horror show that this deficit represents and then, when we start talking about really getting serious, saying, "Huh-uh, it is going to hurt the economy."

You can't have it both ways. I think it would be beneficial, and I know it would be beneficial in terms of the trade deficit, because it would show performance by the United States on its commitments undertaken at international meetings, such as we have just concluded in Paris.

DEFICIT REDUCTION COMMITMENTS TO EUROPEANS

Senator KASTEN. I would like to ask you more specifically about that. As part of the G5 agreements or G5 effort to stablilize the dollar, did you make a commitment to the European nations that we would reach our $108 billion target?

Secretary BAKER. What we said was that we, the administration, would meet the Gramm-Rudman-Hollings targets, and indeed, we have by the budget that we have submitted.

We also said that we would continue to fight protectionism in the United States and that we would seek the adoption of a broad range of measures to enhance U.S. competitiveness. That is what we said in the recent agreement.

Senator KASTEN. In your judgment, what would our major trading partners say, or what would be their view if the $108 target were not met by Congress and, instead, we backed off by—what are they talking about, $20 or $30 or so billion?

Secretary BAKER. They would prefer to see us try to continue to try and meet that target.

U.S. TRADE DEFICIT

Senator KASTEN. I just want to make one other comment with regard to what the chairman said a moment ago about the trade deficit and the problems that we have got. I just want to basically commend you for the work that you did last weekend.

I share your view that one of the major solutions to expanding U.S. exports and also to fight off protectionism is to promote pro-growth economic policies in our major trading partners. We are not going to sell our products abroad, and third world countries aren't going to sell their products unless we see those developing economies grow.

It seems to me that the best thing we can do is to move in the direction that you were able to move in and spur the kind of growth economic policies that we have been able to put into effect here.

Secretary BAKER. Thank you, Senator Kasten. You are absolutely right. Let me just say something that I haven't had a chance to say this morning. The United States has picked up 55 to 60 percent of the increase in exports from lesser developed countries over the past couple of years. We have been the market for the world, and we have furnished the growth for the world.

The point that we have been making with some of our major trading partners who have substantial surpluses is that it is time for them to join us in this effort, and we were able to secure some commitments in that connection in Paris. The Japanese agreed to take some additional actions; the Germans agreed to take some additional actions. We really need to continue to work on these problems cooperatively with the major industrial countries of the world.

Senator KASTEN. Mr. Chairman, thank you.

CHANGES TO $108 BILLION DEFICIT TARGET

Chairman STENNIS. Senator Grassley, you are recognized.

Senator GRASSLEY. Thank you very much. Along the line of what Senator Hatfield and Senator Kasten have said about the $108 billion deficit target under Gramm-Rudman-Hollings we should meet, just in support of that proposition and your position on it, the eleven Republican members of the Senate Budget Committee sent a letter to Senator Chiles, the chairman of the committee, expressing our disagreement with the talk around town that somehow that target ought to be changed and probably would have to be changed.

I hope that we will continue that posture down the road. At the very least, we ought to let the process work before we make some conclusion of throwing in the towel, I would guess, or at least that is my view.

Secretary BAKER. The administration shares that view, Senator Grassley.

Senator GRASSLEY. A little more specific now.

Senator HATFIELD. Would the Senator yield at that point for just one moment for a quick injection here?

Senator GRASSLEY. Yes.

Senator HATFIELD. What if the circumstances demanded that we make a reduction of $60 billion in spending rather in order to achieve that $108 billion Gramm-Rudman-Hollings target, Mr. Secretary? Do you see any implications there to the general economy?

Secretary BAKER. Senator Hatfield, I can't really speculate on that. You could ask me that with respect to $90 billion or $125 billion of deficit reduction. I do not see that it will be necessary, as far as hitting that target is concerned, under our analysis of the situation.

Senator HATFIELD. But I indicated that, again, we could face those circumstances and could change that picture. At that point, we would have to really deal with some very serious problems.

Do you think those problems could have an impact on the economy achieving that target under a $60 billion reduction?

Secretary BAKER. I would really prefer not to play that game this morning.

Senator HATFIELD. All right. Thank you.

CHANGES TO W-4 FORM

Senator GRASSLEY. Mr. Secretary, on a more specific point, at an earlier appearance before the Congress, I guess it was on the House side, you mentioned changes in W-4. How are we coming on those? I think they were promised by March 1.

Secretary BAKER. We are coming along quite well, Senator Grassley.

Senator GRASSLEY. They will be announced later on this year?

Secretary BAKER. I don't believe they were actually promised by March 1, but I think the Commissioner of the Internal Revenue said that he thought he would have something to say by that time, and good progress is being made.

INSPECTOR GENERAL

Senator **Grassley**. Then on a question that would involve appropriations to some extent if Congress would create an office of Inspector General in the Treasury Department, this is a follow-on of an introduction of a bill at Congress under Senator Pryor's leadership. With the help of new Senator Reid and following on Senator Reid's work in the House last Congress and work that I have been doing over several years when we were the Majority and I was on the Finance Committee, we are introducing today what we call a Taxpayer's Bill of Rights. Part of this would be the establishment of an Inspector General's office.

Administratively, there is an Inspector General. General Accounting Office, to date, says that they can be involved with 11 percent of the work of the Treasury Department. Every other department except Justice and Treasury has a statutory, independent Inspector General's office. Even the Defense Department has one.

We would see this, through putting the taxpayers on a more equal footing with the IRS, as one way of helping to see that that is done. Even the IRS has admitted inefficiencies in taxpayers abuses. They can give you some statistics of some 80 people in 1985 who were convicted of some sort of violation of law as they were dealing with taxpayers.

So I think we acknowledged the need. I guess I would ask you not so much in a question, but to work with us on that. I think it has been objectionable to the Department in the past. Maybe we haven't made a good enough case for it. I think we can make that case. We are just now introducing the bill today, so officially, it is just on the agenda.

Secretary **Baker**. Senator, let me say, of course, we will take a close look at it, and we will work with you, as we have in the past on other matters. The reason that you have two departments that don't have a statutory I.G. is because you have two departments in this government that are engaged, to a large degree, in law enforcement. The one thing you want to be, I think, cautious about—at least as I understand it this has been the rationale—is that you don't in any way increase the possibility of politicization of that process.

That is the reason Justice doesn't have a statutory I.G., and that is the reason Treasury, with fully 85 or 90 percent of its personnel being in law enforcement, doesn't have a statutory I.G.

Senator **Grassley**. I believe we can accept your argument on those two points, and our bill would specifically prevent the Inspector General from revealing fiscal policy and interfering in any way with litigation.

Secretary **Baker**. Interfering with litigation is one issue, yes, but I think what you have to be careful about is in any way interfering with the law enforcement process, not just litigation, and that is why Justice and Treasury have historically not had statutory Inspector Generals.

But will we work with you, you bet, as we have before. We may wind up not being able to agree, but we will work with you.

Senator **Grassley**. I guess I feel I can make a case based on the documentation IRS has given to us, at least to some extent, at least on the initial processes, that there is a legitimacy for some outside enterprise like an Inspector General looking into this.

TAXPAYERS' BILL OF RIGHTS LEGISLATION

Let me also say, what sort of conclusion should I draw? Without going into a lot of other aspects in my Taxpayers' Bill of Rights, there is obviously a lot of things in there that people in the IRS find offensive. What sort of pre-conclusion would I draw that the District Director of Internal Revenue, Des Moines, IA, called up my office yesterday morning after it was reported in the press introduction of this bill, "hot under the collar"? That is the expression of my staff who talked to him about the legislation.

Secretary **Baker**. I don't know what is in your legislation, so I can't hazard a guess, Senator.

Senator **Grassley**. It calls for Miranda-type notification to taxpayers of certain rights they have. It provides that the Problem Resolution Officer in the Secretary in the IRS would be able to initiate action rather than just recommend action. It would make the IRS stick to installment payment of taxes if they made an arrangement with the taxpayer for the installment payment of taxes.

It would deny use of any statistics on the amount of money that an employee of the IRS might collect through auditing as a basis for promotion or advancement. IRS denies that that is done, but I think we have ample evidence that it is done, and a lot of other things that would fall into the category of Taxpayers' Bill of Rights that we have introduced.

We have introduced these bills in the past. Sometimes we have gotten certain parts of them passed. But at least some IRS employees are taking violent exceptions to the legislation, or that is the message I get.

Secretary **Baker**. Of course, I couldn't hazard a guess about why somebody made a call, the contents of which I don't even know. We have over 130,000 people in the Treasury Department, and I am sorry I can't help you there.

Senator **Grassley**. I guess I am just wondering, is there some sort of message I am supposed to get when the District Director of Internal Revenue calls up a person that is sponsoring the bill that is an anathema to the bill?

Secretary **Baker**. Senator, I can't hazard. I don't know anything about the call. I couldn't respond to that.

Senator **Grassley**. Thank you, Mr. Secretary.

Chairman **Stennis**. Thank you.

MULTILATERAL DEVELOPMENT BANK LOANS

Senator Lautenberg, that brings us to you. We are running an experiment here, the 10-minute rule. I am not limiting you to 10 minutes, finally, but you may start.

Senator LAUTENBERG. Mr. Chairman, I appreciate the admonition. I will be very careful in my use of time for Mr. Baker. I think it is probably a good idea.

Chairman STENNIS. You misspelled a word, admonition. Go ahead.

Senator LAUTENBERG. No, no, I didn't mean it.

Secretary Baker, it is good to see you.

Secretary BAKER. Senator.

Senator LAUTENBERG. I am sorry I wasn't here to hear your testimony.

WORLD BANK SUPPORT OF COUNTRIES SUPPORTING TERRORISTS

I just have a couple of questions related to World Bank support of countries that are known to support terrorism. Under existing law, the United States partly used its voice in the vote of the Multi-National Banks to channel assistance away from countries which provide refuge for individuals committing acts of international aircraft hijacking.

What is our policy with respect to Multilateral Development Bank loans to countries under the Secretary of State's terrorist list? We have Syria, South Yemen, et cetera.

Last year, the World Bank made two loans totaling $77.5 million to Syria, a country that has been on the Secretary of State's terrorist list for some time, actually, since 1979.

Any country on that list has been found by our Government to provide consistent state support for terrorism. Now our representative in the World Bank abstained on these loans on the grounds that Syria violates human rights.

Is any consideration given, can you tell me, to voting "no" on these loans because Syria is on the terrorist list?

Secretary BAKER. I can't answer that specifically, Senator Lautenberg, but I will tell you that an abstention is an opposition vote. In other words, we vote "no" sometimes. We abstain sometimes. An abstention is every bit as good a vote in opposition because you can't count the United States' voting share toward approval. The loan won't pass if others don't provide the necessary percentage, and if others join us.

I would be surprised, frankly, if we simply abstained on a loan to a country that is on the Secretary of State's terrorist nation list.

Senator LAUTENBERG. As contrasted to, just saying "no" flat out?

Secretary BAKER. Yes, sir, and I would be delighted to check that.

Senator LAUTENBERG. If you would, I would appreciate it.

Secretary BAKER. It would seem to me that a more appropriate policy there would be to just simply say that we were going to vote "no" on all those loans, but I am not familiar with the loan you mention.

Senator LAUTENBERG. I would appreciate that response.

Would you support an amendment to the Foreign Assistance bill requiring the United States Executive Director to oppose, to vote "no" on loans for terrorist countries?

Secretary BAKER. I would rather not see us load this up, if I may say so, Senator, with a lot of provisions to try to micromanage what we do there.

I would rather have the executive branch make a commitment to you that this would be our policy and then have us carry it out. Because there could come a time, I suppose, where there might be a reasonable basis for an exception—for example, if you had a country that was moving away from that type of activity and you wanted to encourage them to move further, and so forth.

So I would not, I couldn't give you a pledge this morning to support such an amendment. I do think that as a policy matter, we ought to vote against loans to countries on that list.

Senator LAUTENBERG. Mr. Secretary, if you would review that and make a decision that way, I think that would be helpful.

Secretary BAKER. I will be glad to do that and will be back in touch with you promptly.

Senator LAUTENBERG. Thanks.

RECORDING FACE VALUE OF NEW LOANS

On the subject of loan sales, I think you and I may have discussed it before in other circumstances, at a meeting, I think, of the Budget Committee.

Last week, Dr. Feldstein was before the Budget Committee, on which I serve. We talked about loan asset sales. He said selling old loans had no salutary effect on the deficit. He argued that if we do sell old loans, we shouldn't count the income against Gramm-Rudman-Hollings targets. He agreed with writing down new loans, which is, frankly, a policy that I think we ought to initiate, to their face value by recognizing the discount of the subsidized interest rate.

How do you feel about that position? Why wouldn't it have an effect, in your view?

Secretary BAKER. Why wouldn't it?

Senator LAUTENBERG. Yes.

Secretary BAKER. In my view it would.

Senator LAUTENBERG. It would?

Secretary BAKER. Yes.

Senator LAUTENBERG. I agree with you.

Secretary BAKER. I totally disagree—I won't add anything to that.

Senator LAUTENBERG. That is pretty direct.

DROP IN VALUE OF DOLLAR

One last question, Mr. Chairman. We heard much about how the dollar's dropping in value against the yen and mark would improve our trade position.

However, while the dollar has been falling, our trade deficit with the Asian countries of Taiwan, Korea, and Hong Kong, has continued to rise. What are you planning to do, if anything, to bring the currencies of these countries in line so that we can get the effect that we would like to see?

Secretary **Baker**. At the meeting over the weekend in Paris, the six industrialized countries meeting there recognized this problem, and we spoke to it in our communique, Senator Lautenberg. Basically, what we say is those are newly emerging industrialized countries, and as such they should recognize their obligation to permit their currencies to become competitive.

As they tend to do better in world trade and build up surpluses and improve their economies, if they are going to be playing with the big boys, to play by the same rules.

That is basically what the communique said. We have been in touch with some of these countries. We try and do it quietly and privately because it is harder to achieve these things if it is done publicly. But we have seen some appreciation in the currencies of these two of those countries as a consequence of our contacts.

Senator **Lautenberg**. Without asking you specifically, that is a matter that you will continue to review and to press?

Secretary **Baker**. Yes, sir.

Senator **Lautenberg**. Thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman **Stennis**. Thank you, Senator.

Senator Sasser, that brings us to you, sir. I recognize you.

Senator **Sasser**. Thank you, Mr. Chairman.

VALUE OF FOREIGN GOODS

Mr. Secretary, it is good to see you this morning. One question comes to mind. Historically, as we have seen the dollar come down in the international currency markets, we have seen the inflation-adjusted value of foreign goods in our U.S. market go up.

What we have seen over the past year or year and a half as the dollar has come down, is the inflation-adjusted value of foreign goods in the U.S. market has remained virtually stationery according to the figures that I have seen. What would be your explanation for that, No. 1, as to why the value of these foreign goods are not coming down; and No. 2, what does that say to our efforts to lower our trade deficit?

Secretary **Baker**. I think that to the extent that those prices have not gone up, Senator, it is due to the desire on the part of exporters to the United States to try and maintain market share, and they have been, if you will, eating the difference. They can't continue to eat the difference forever.

So I think you will see the phenomenon that you have mentioned that usually occurs, in fact, occur, and I think you will see the price of those goods tend to increase.

I think, as I said before you came, we need to understand that it takes a long time for exchange rate changes to be reflected in trade figures.

We are only 16 months away from the Plaza Hotel meeting of September 1985. We have begun to see our trade deficit level off. If you go back 6 months, you see the monthly figures are not continuing to get worse, except for one abberational month. That would indicate or suggest, at least, that we ought to see it begin to turn down reasonably soon.

We are projecting a $20 billion reduction in the trade deficit in 1987.

ENFORCEMENT OF UNFAIR TRADE LAWS

Senator SASSER. Mr. Secretary, when we get into the discussions here in the Congress among ourselves and then in discussions between the congressional members and the administration, we throw around such terms as protectionism and free trade. One of the arguments that is advanced against those who might advance ideas that would border on protectionism or could be termed protectionism is that if we erect barriers, that there is going to be reciprocity on the part of our trading partners against U.S. goods for the international commerce.

But it appears to me that what we have seen in recent months with the fall of the dollar and, as you say, foreign manufacturers willing to eat profits to a certain extent, simply to have access to this, the most lucrative consumer market in the world, would indicate that at least to my mind, an argument could be made that moderate efforts to try to enforce fair trade would not necessarily evoke responses from our trading partners.

In other words, when we bring this dollar down, if you have taken steps to bring the dollar down, I applaud you for doing it. I think you are following the correct policy; your predecessor and also Mr. Sprinkle had indicated to us that it couldn't be done, that with the sheer volume of the world currency market, nothing could be done to bring the dollar down.

I think you have indicated by your performance that something can be done to bring the dollar more in line with the currencies of our trading partners.

I suppose my point is that in bringing the dollar down, to some extent, we are erecting barriers against foreign goods coming into this country. Yet they continue to come in here; yet they continue to eat those profits simply to have access to this market.

Secretary BAKER. You suggested that the fact that exporters to this market are willing to eat the depreciation argues for at least a moderate enforcement of our unfair trade laws. Senator, I would argue that it argues for more than that. We have, in fact, at least for the past 2 years, been engaged in much more than simply a moderate enforcement of our unfair trade laws. I think the administration's enforcement of these laws has been very aggressive for a period of 18 months to 2 years, without going into what did or didn't happen before then.

This President is the first President in history to self-initiate 301 cases against our trading partners, and he has done so in about eight instances with some pretty darn good results. We have been granted more import relief than any administration in 30 years.

So I would argue that we are aggressively enforcing unfair trade laws, and we have got to continue to do that. Of course, we make that argument in suggesting that we don't need to make a lot of changes of those trade laws. We already have some very effective tools. The important thing is to use them.

We do suggest, in our competitiveness package, one change in the trade laws that moves specifically in the direction you are talking about; specifically that we have available to the President of the United States, as an additional factor to be considered in whether or not you are going to file an unfair trade case against another country, reciprocity. That is, are we afforded the same rights in their markets as they are afforded here?

That is a proposal that we are making. We think that should be added to the arsenal. But I don't think there is any difference between you and us. We need to continue to aggressively enforce these laws and in so doing in a manner that will not result in cutting us off from foreign markets.

What would cut us off from those markets, if I may say so, are measures to close down our markets here in the United States, with across-the-board tariffs, things like that.

TRADE MARKETS IN THE FAR EAST

Senator SASSER. You may be right about that, Mr. Secretary. I don't want to pursue this thing unduly, but when we start talking around here about free trade versus protectionism, I would say to you that yes, I am a free trader when it comes to trading with the British, perhaps, or the West Germans and some of our other western European trading partners. But obviously, we can't free trade with the Soviet Union because there is no such thing as free trade on the part of the Soviet Union.

When you start moving into another tier of countries, Japan, Taiwan, Korea, I would submit that an argument can be made that there is no such thing, really, as free trade with those countries, that we are going to have to have a different approach to trade with perhaps Japan and Taiwan and Korea than we do with our more traditional and long-term trading partners in Western Europe, where I think we can free trade and where the old trade patterns and old trade markets work.

I am not sure they do with some of these new emerging industrial giants and emerging authorities in the last two decades.

Secretary BAKER. I think historically, markets have been more open in Europe than they have in the Far East, and we need to continue to spend every effort to get those countries to open their markets and give us the same access there that we give them here. I totally agree with that.

Senator SASSER. If I just might say one other thing, I am a Senator from a tobacco-producing State. At last count, we had 38,000 out of 264 tobacco farmers. Our cigarettes in Japan are limited; U. S. imports of Japan imports are limited to 2 percent of the Japanese cigarette market, and they are marketed there through the Japanese tobacco monopoly. Our manufacturers can't get advertised in Japan.

Secretary BAKER. I think that has been changed, if I am not mistaken, Senator, as a consequence of one of the section 301 cases that we handled recently. I think we have now been given much greater access for tobacco in the Japanese market.

It is a good example of what I meant when I said this is the first President in history to self-initiate these cases. I believe I am right on that.

Senator SASSER. I hope you are right. They have been promising to do that for years, and 3 years ago, Mr. Nakasone personally promised me they were going to change that. If it has been changed, it has been within the last 2 months.

Secretary BAKER. It was relatively recently; that is right.

Senator SASSER. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman STENNIS. Thank you, Senator. Thank you very much.

ADDITIONAL COMMITTEE QUESTIONS

Mr. Secretary, is there anything you wish to add to the record?

Secretary BAKER. No, thank you, Mr. Chairman.

Chairman STENNIS. I have here questions of various members, and I ask unanimous consent that they be inserted in the record for the respective Senators, and you can give this your attention in giving answers.

Secretary BAKER. Yes, sir.

Chairman STENNIS. I have a few questions of my own and some comment, if there is no objection to including those in the record for the attention of Mr. Baker.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY CHAIRMAN STENNIS

REVENUE

Senator Stennis: Secretary Baker, the President's budget is supposed to meet the Gramm-Rudman-Hollings deficit target of $108 billion. The budget insures revenues for fiscal year 1988 will be $916.6 billion. Last week Dr. Penner, Director of the Congressional Budget Office testified before that Committee and projected that the President's budget misses the targets by $27 billion. In his testimony, he also pointed out that to an economist's point of view, a 1 percent margin of error was almost negligible. Of course, from a political perspective, a 1 percent error in estimating the revenues could determine whether or not a sequester would be required to meet the deficit target for fiscal year 1988.

Revenue estimates are very sensitive to change in economic assumptions. Last year you calculated that an error of 1 percent in real GNP growth would cost $6.2 billion in fiscal year 1987 revenues and $17.7 billion in fiscal year 1988 revenues.

Given that the revenue estimates are calculated with a new tax code, what is the high and low range that the revenues could be for fiscal year 1988?

Do you have empirical evidence to support your estimate that an additional $2.4 billion in receipts will be collected if we increase fiscal year 1988 IRS funding to $5.1 billion?

Secretary Baker: A 1 percentage point sustained error in the rate of real growth, beginning October 1987, would cause receipts to be off $5.6 billion in fiscal year 1988 and $15.3 billion in fiscal year 1989. A 1 percentage point sustained increase in the forecasted rate of inflation, beginning /October 1987, would cause receipts to increase $6.1 billion in fiscal year 1988 and $16.1 billion in fiscal year 1989. Although we do not expect real growth to drop or inflation to rise from their forecasted levels, either of these results is possible.

We expect the IRS receipt initiatives in the budget to raise receipts an additional $2.4 billion in fiscal year 1988. This estimate is based upon a great deal of experience analyzing the impact on receipts of additional spending for Internal Revenue Service tax compliance and enforcement programs. We know exactly how much revenue is collected through the enforcement and compliance programs, and, for years, we have carefully monitored changes in tax collections associated with changes in compliance and enforcement spending. This has enabled us to accurately predict the pay-off resulting from an additional dollar spent on various IRS programs and activities. For 1988, the ratio of additional tax collections to costs associated with the IRS receipt initiatives is about 6 to 1. Over the entire 1988-1992 budget period, the yield is more than $7 of additional tax collections for each $1 of new spending.

STATUTORY DEBT LIMIT

Senator Stennis: In September, 1981, Congress had to approve the first trillion dollar Public Debt Limit.

This past summer, Congress had to increase the permanent public debt subject to limit from $2.079 trillion to $2.111 trillion. An additional temporary increase of $189 billion was passed in last year's reconciliation measure. This temporary measure expires May 15, 1987.

Do you expect this limit to be sufficient to cover our needs to May 15?

Secretary Baker: Current estimates indicate that the temporary ceiling provides sufficient borrowing authority through May 15, including settling the May regular mid-quarter refunding. An increase in the debt ceiling will be required soon after May 15, because the Treasury will not be able to roll over maturing bills after that date.

Senator Stennis: What is your estimate of the public debt subject to limit for Fiscal Year 1988 and each subsequent year?

Secretary Baker: The table below presents estimates of debt subject to limit through FY 1992.

End of Fiscal Year	Debt subject to limit ($millions)
1986 act.	2,110,975
1987 est.	2,353,258
1988 est.	2,572,967
1989 est.	2,790,813
1990 est.	2,986,693
1991 est.	3,157,987
1992 est.	3,305,321

Source: FY 1988 Budget

ASSET SALES

Senator Stennis: Secretary Baker, you have mentioned that the President's Budget proposes to shift away from government some of the government activities which can be better handled by the private sector. One of these proposals includes the sale of government acquired assets such as the sale of government owned loans. You mention that the President's Budget proposes to sell loans with a face value of $11.2 billion in 1988 to produce $5.3 billion. You point out that this type of sale will save administrative costs for the life of the loan but will reduce the deficit by the amount received on the loan sale. However, you recognize and point out in your statement that these sales will actually increase the deficit in the out years.

Senator Stennis: Will these sales have an overall positive affect on the deficit?

Secretary Baker: As I pointed out in my statement, loan asset sales reduce current budget deficits by the net amount received from the purchasers of the assets. However, such sales increase future deficits because they move to the present anticipated future streams of principal and interest payments from the loans. It should be noted this effect on future deficits is mitigated by several factors. First, revenues from asset sales reduce Treasury borrowing and, therefore, lower interest outlays in subsequent years. Second, the savings from improved management of credit programs that occur as a consequence of asset sales are not explicitly reflected in the budget. Finally, the discounts at which the loans are sold measure the present value of the subsidies implicit in the loans. The "loss" recognized at the time of sale merely makes that subsidy explicit.

Senator Stennis: Has there been an analysis done by your people comparing the administrative cost during the life of the loan to the cost which will be incurred during the process of selling the loans?

Secretary Baker: Treasury has not done such an analysis of the administrative costs incurred during the life of loans and the costs involved in selling such loans. Individual program agencies involved in loan asset sales would be in a better position to make such analyses because they possess the necessary programmatic data to project the administrative costs over the life of the loans which they administer, and in conjunction with their financial advisors on the asset sales, they would be better able to assess the costs which will be incurred in selling the loans.

QUESTIONS SUBMITTED BY SENATOR CHILES

REVENUE ESTIMATES

Senator Chiles: On Wednesday of this week we heard testimony from OMB Director Jim Miller who told us he felt there was a very good likelihood of meeting the $108 billion deficit requirement of Gramm-Rudman even though CBO's preliminary estimates put the deficit under the President's budget proposal $27 to $30 billion higher.

The President's budget estimates 1988 revenues to be $916.6 billion. What probability or likelihood do you give to reserves actually reaching $916.6 billion?

As you know, last October before the 99th Congress adjourned the 1987 deficit was estimated to be approximately $154 billion. In January the estimates had climbed to $174 billion with $12 billion of that change due to lower than expected revenue estimates. With regard to the change in revenue estimates, what happened between October and January?

Secretary Baker: We have estimated receipts to be $916.6 billion in 1988. We cannot assign a simple probability to the accuracy of that projection. The revenue estimating process is too complex: it involves forecasting economic performance over the next seven calendar quarters, predicting how individual taxpayers and businesses may change their behavior in response to the new tax law, and gazing into a crystal ball to "see" which of the President's $6.1 billion worth of revenue raising proposals Congress will adopt. Our track record show that once we have these answers, our revenue estimates are likely to be off by less than 1 percent.

The $154 billion deficit estimate that you refer to was based on the forecast of current service receipts and outlays published in the Administration's Midsession Review of the Budget (modified slightly to reflect the budget "base" level of revenues and outlays as required by H.J. Res. 372). In both the initial and the revised Sequestration Reports or Fiscal Year 1987 (released on August 20 and October 6, 1986 respectively), the Administration's forecast of receipts, outlays and the deficit were:

Receipts	$826.4
Outlays	$982.6
Deficit	$156.2

The revised Sequestration Report indicated that there were legislative actions underway which, if enacted as expected, would reduce the estimated deficit below $154 billion.

Estimated FY 1987 receipts (on a current service basis) published in the Fiscal Year 1988 Budget are $842.3 billion, an increase of $15.9 billion over the level used in the Sequestration Report.

MEDICARE CATASTROPHIC HEALTH COVERAGE

Senator Chiles: Mr. Secretary, the Secretary of Health and Human Services, Dr. Bowen has proposed a plan for catastrophic health coverage for the elderly. A great emphasis has been placed on individuals preparing themselves for future medical expenses. Included in Dr. Bowen's plan is the creation of tax-free individual medical accounts (IMAs). These accounts would allow working Americans to shelter up to $1,000 a year in a savings account earmarked for nursing home care.

From you perspective as the Secretary of Treasury, do you think this a good idea?

Are there any other incentive mechanisms to encourage individuals to save for future medical expenses?

Does the Administration intend to propose any of these ideas to the Congress?

Secretary Baker: The President has directed the Treasury Department to study ways in which long-term health care for the elderly can be improved. We will be looking into the individual medical account (IMA) proposal as well as other incentives to encourage new savings to help solve the long-term health care financing problem.

We are concerned that IMA deposits, at least at the outset, could simply encourage people to shift existing savings without increasing the overall amount of savings necessary to solve the problem.

One focus of our concentration will be on ways in which the overall amount of private savings could be increased and directed toward insurance to pay for long-term health care of the elderly. We will be studying how the private insurance market may respond to the elderly's need to finance nursing home care. We will be looking at ways to encourage Medicare beneficiaries to enroll in private health plans that provide catastrophic health coverage.

It would be premature to speculate now on the policy suggestions our study will recommend; however, we will be pleased to keep Congress informed as our evaluation of these issues progresses.

Tax on Employers to Cover Pension Costs

Senator Chiles: Last year, Congress raised employer's premiums from $2.60 to $8.50 per worker to cover the escalating cost of terminated pension plans with insufficient assets, which must be paid by the Pension Benefit Guarantee Corporation. Now, with more and more failing industries, we understand the Administration plans to ask Congress to significantly raise premiums once again. Exactly how much should premiums go up? When would this premium increase take effect? How much increased revenue is needed to cover all currently foreseeable business failures?

(Background: It appears premiums may have to double just to cover the LTV bankruptcy alone. The Administration apparently plans to ask for variable premiums, so that employers with underfunded pension plans would be required to pay more.)

Secretary Baker: I believe this question should really be addressed to the PBGC or the Labor Department, but let me tell you what I know about the plans for a premium increase. Later this year the PBGC will present proposed legislation to Congress that would provide for a change in the premium structure.

They are considering a two-part premium. The first part would be a flat rate per pension plan participant, close to the present $8.50 premium. This charge would cover costs that cannot easily be allocated on the basis of the likelihood of future claims, for example, the PBGC's administrative expenses and a share of the deficit that was accumulated in the past.

The second part of the premium would be based on the plan's funded status. This charge would be zero for plans that exceeded some basic level of secure funding -- approximately 120 - 125 percent of liabilities valued well on a termination basis. For plans that were less funded, there would be a charge based on the difference between this basic level and actual plan assets. We expect that his charge would be about $6.00 to $10.00 per $1,000. No plan, however, would pay more that $100.00 per participant, regardless of the magnitude of its underfunding.

The new fee structure would take effect only after it is approved by Congress. PBGC should be able to give you more details on its revenue projections for the new fee structure and its revenue needs to cover liabilities from insured pension plans it has already taken over.

BALANCE OF TRADE DEFICIT/STRENGTH OF THE DOLLAR

Senator Chiles: Mr. Baker, as you know, since last spring the value of the dollar has dropped 20 percent, but our trade deficits continue to set record negative balances. Why hasn't the drip in the value of the dollar helped improve our balance of payments situation?

Secretary Baker: the dollar's substantial decline has been largely responsible for:

-- levelling-off of the trade deficit over the past three quarters, preventing further deterioration;

-- prospects for a reduction of perhaps $20 billion, to $130 billion (balance-of-payments basis, equal to $150 billion census/c.i.f. basis) this year;

-- possible modest further reduction in 1988.

-- We have maintained for some time that the exchange rate can't do it all; also need stronger growth abroad.

Senator Chiles: Mr. Baker, yesterday's Post reported that you have agreed with the Japanese to help stabilize the exchange rates in order to stop the further decline of the U.S. dollar. Exactly what steps are you proposing to meet this objective?

Since the decline makes Japanese goods more expensive and U.S. goods cheaper, this situation should help our international competitive position. In view of this fact, how far are you prepared to go to stop the fall of the U.S. dollar?

Secretary Baker: The Administration has focused a great deal of time and attention on strengthening international economic cooperation among the industrial nations to achieve exchange rates in line with economic fundamentals and to promote balanced growth. We have maintained for some time, however, that exchange rate changes should not be relied upon as the sole means of correcting trade imbalances. Improved growth in our major trading partners is also needed to complement exchange rate changes.

At the Paris meeting on February 22, 1987, surplus countries committed themselves to follow policies designed to strengthen domestic demand and to reduce their external surpluses while maintaining price stability. Deficit countries committed themselves to follow policies designed to encourage steady, low-inflation growth while reducing their domestic imbalances and external deficits.

There was broad recognition at the Paris meeting that further substantial exchange rate shifts could damage growth and adjustment prospects. In current circumstances, therefore, the participants agreed to cooperate closely to foster stability of exchange rates around current levels.

The experience of recent years demonstrates that governments must retain flexibility in dealing with exchange market pressures. Efforts to establish rigid exchange rate objectives or to specify too precisely the goals of intervention would lead inevitably to speculative capital flows that would overwhelm the government's ability to react effectively. While there are clear understandings among the major countries regarding cooperation, we have refrained from establishing a system of target zones or ranges and have not spelled out the manner in which we intend to deal with possible market developments.

IMPACT OF TAX CHANGES ON EDUCATION

Senator Chiles: The tax bill made several changes that could have a devastating impact on higher education. The new law taxes scholarships and gifts of property to colleges, and curtails deductibility of student loan interest and contributions to non-profit colleges.

> Isn't it enough for higher education to bear the burden of these tax law changes without also requesting massive cuts in the student financial aid programs?

Secretary Baker: The Administration does not believe that the tax law changes will have a major, adverse impact on higher education. In general, scholarships of degree candidates will remain untaxed. Moreover, to the extent that the portion of scholarships and fellowships covering living expenses is subject to tax, any potential tax will generally be offset by the student's increased standard deduction -- unless that student has significant other income.

Since student loans tend to be repaid shortly after students graduate, when they generally do not itemize their deductions, must of the interest on student loans was not deducted even under prior law. Moreover, the Tax Reform Act's special provision which permits the continued deduction of student loans where the loan is secured by the borrower's home will allow the interest on many educational loans to remain deductible.

QUESTIONS SUBMITTED BY SENATOR DECONCINI

Senator DeConcini: Mr. Secretary, I have written you a letter concerning African Development Bank loans to the Marxist government of Angola. This letter, objecting to loans, is signed by fifteeen of my colleagues, Democrats and Republicans alike. I have recently read the Country Reports on Human Rights practices for 1986, submitted by the State Department to Congress in February 1987. Let me read from it, Mr. Secretary:

Senator DeConcini: "In fact the Angolan People live under censorship, intimidation, and government control of the media. Opposition views are not tolerated ... The government publicly emphasizes the importance of propagating atheism and has been critical of all religious activities ... Citizens do not have the right to change their government ..."

Senator Deconcini: This is deplorable and pitiful human rights record by a government that has imported over $4 billion in Soviet military equipment. This is a government that houses and feeds 35,000 Cuban troops and 2,000 Soviet advisers. Loans from the African Development Bank, such as the recent $19 million fish hatchery, help feed those troops and free money for military hardware. I understand that the U.S. has abstained in its vote, but the loans continue. Mr. Secretary, you come up to the Hill to seek U.S. taxpayers dollars to international affairs and MDB's, yet loans go toward this Marxist government and our domestic programs such as drug enforcement and education are cut.

Senator Deconcini: This type of foreign assistance is not high on my priority list or Arizona's list. I would like to urge you, Mr. Secretary, to convey to Secretary Shultz and President Reagan that this skewed foreign policy in Angola should not continue. I ask you to do all in your purview and power to address this issue. I would request that you take a personal interest in this. I do not seek a legislative response, yet one seems to be looming on the horizon. In addition to abstaining on a vote, what else can you do to address this concern?

Secretary Baker: The United States had been abstaining on human rights grounds on all multilateral development bank lending to Angola since 1983. Those abstentions have been a way of opposing the loans and indicating our concern about violations of human rights in Angola. In response to your letter, I have asked the U.S. Executive Director of the African Development Bank to advise management of our continuing opposition to loans to Angola and to bring your concerns to their attention.

Senator DeConcini: United States Trade Representative, Clayton Yeutter, predicted last week in testimony with you that the trade deficit, which totaled $170 billion last year, could drop by $30 billion to $40 billion a year over the next two years. Mr. Secretary, last year, despite trade negotiations with the Japanese, the U.S. ran the largest deficit ever with the Japanese. This was over $60 billion. $60 billion could go a long way toward American drug education or job re-training. Are you as quixotic as Ambassador Yeutter in predicting the trade deficit? What is the Administration doing to eliminiate Japanese barriers to U.S. products?

Secretary Baker: We expect the U.S. trade deficit on a balance of payments basis to decline about $20 billion (to about $130 billion, balance-of-payments basis or about $150 billion, Census/c.i.f. basis) this year with some further reduction likely (on current exchange rate and U.S./foreign growth assumptions) in 1988.

In our approach to trade relations with Japan, we intend to continue working in these areas: stimulation of domestic economic growth; financial market liberalization; and intensive negotiations to deal with specific trade problems. These negotiations have been sector-specific as well as product-specific. When appropriate the United States Government has availed itself of GATT and Section 301 procedures.

Specific examples of sector negotiations that have reduced Japanese barriers to U.S. products include the market-oriented, sector-selective (MOSS) talks on medical equipment and pharmaceuticals, telecommunications, and forest products. Others have been in the areas of cigarettes, alcoholic beverages and legal services.

Presently we have in process talks with the Japanese to make sure that the semiconductor agreement is being correctly implemented, that U.S. firms can adequately participate in the Kansai airport project, that U.S. auto parts producers have access to Japanese vehicle producers, that the government-funded market in Japan is open to U.S. supercomputer firms, and that U.S. agricultural and fishery products have fair access to Japan's markets.

Senator DeConcini· Recent news reports stated that U.S. banks are going to permit Chile to pay its interest payments in one lump sum and that Citibank has agreed to this "retiming" proposal under U.S. Government pressure. What impact will this have on U.S. banks? What is the U.S. Government position on this type of retiming proposal and will similar treatment be accorded other debtors (specifically, Ecuador and the Philippines)?

Secretary Baker: The Government of Chile and its Bank Advisory Committee have reached agreement in principle on the repayment terms on the debt owed to the international banking community. One of the provisions in the proposed agreement is that Chile would pay interest on an annual instead of semi-annual basis during 1988 and 1989. This provision has the effect of deferring about $400 million in interest payments during the latter six months of 1988 into early 1989, and again deferring $400 million during the last six months of 1989 into early 1990.

Switching from semi-annual to annual interest payments was a major objective of the Government of Chile because it would allow Chile to defer interest payments during the part of the year when export receipts tended to be low. Thus, retiming would have the effect of smoothing out Chile's foreign exchange inflows and outflows.

-- Banks initially resisted the request, but eventually went along as an alternative to new financing.

-- We believe that the effects on U.S. banks from retiming of Chile's interest payments are insignificant.

-- The U.S. Government is neutral toward the modification of financing terms that have been reached voluntarily by the banks and debtor nations. Similar retiming terms could surface in future reschedulings.

— Payment of interest on an annual basis is standard practice in the Eurobond market.

Senator DeConcini· Press reports also indicate that the Treasury opposed World Bank participation in Chilean lending. Is this accurate and what will the Treasury's position be in the future with respect to loans to Chile?

Secretary Baker: That is correct. The human rights situation in Chile has been a matter of gross concern for us. Recently we have been abstaining on human rights grounds on multilateral development bank loans to Chile that do not meet basic human needs. We are continuing to monitor the situation in Chile very closely and will be considering all loans to that country on a case by case basis.

Senator DeConcini: Ecuador didn't make its January interest payment and Brazil has suspended its commercial interest payments. Is this indicative of a trend in Latin America?

Secretary Baker: Brazil unilaterally limited debt service payments in response to declining reserves and small monthly trade surpluses. This decision permits continued payments to the IMF, other multilateral financial institutions, and foreign governments, while temporarily suspending interest payments to commercial banks. On the other hand, Ecuador, while negotiating with the commercial banks, temporarily deferred bank interest payments in order to ensure that net reserve did not fall below the end-January 1987 of $135 million. While these measures are unfortunate, they represent special, specific responses to sharp deteriorations in their financial situation. We do not believe these developments will set a trend in Latin America. Indeed the commercial banks have subsequently reached agreement with Chile on a retiming and repricing arrangement and an agreement with Venezuela on a rescheduling of principal payments due on previously renegotiated debt, at lower spreads.

Senator DeConcini: Latin American living standards are declining and U.S. exporters are losing business because these countries cannot afford to import. Argentina has entered debt talks with its private creditors and its finance minister has been quoted as saying that Argentine economic growth is non-negotiable. Haven't we reached the point where some debt write-off is necessary, and if not, why not? What is the Treasury's "solution" to the problem?

Secretary Baker: Treasury firmly believes that the debt can and should be repaid in full and the "Program for Sustained Growth" is the best way to ensure that that happens. We believe that most of the debtors intend to repay their debt obligations, and in general, most are keeping current on the terms of their debt agreements. Regarding write-offs, we believe that it is entirely the decision of the commercial banks whether to voluntarily write-off Third World debt carried on their books. Neither U.S. policy nor banking laws pose impediments to such write-offs, although for tax purposes, book write-offs are generally not tax deductible unless the banking authorities mandate it.

Senator DeConcini· Peru seems to be going its own way by limiting debt repayment to 10 percent of export earnings and is reported to have fairly good growth (9 percent in GDP in 1986). Is there concern at the Treasury that other countries might follow Peru's approach?

Secretary Baker: Although Peru's economy grew substantially during 1986, it is unsustainable growth. Peru has pursued expansionary domestic policies which have lead to upward pressure on prices. We expect that inflation, which totalled about 65 percent during 1986 despite price controls, will increase substantially during 1987. Moreover, Peru's policies led to the near elimination of its trade surplus during 1986, compared to a $1.1 billion surplus in 1985.

-- In recent months, Peru has imported more goods than it has exported. Gross international reserves declined by more than $400 million during 1986, despite the 10 percent limit on debt service payments. International reserves declined another $100 million during the first month of 1987. We believe that under current policies the economic situation in Peru will continue to deteriorate.

-- Commercial banks have responded to Peru's policy on debt by reducing the availability of trade credits. This has forced Peru to use its limited international reserves to facilitate trade.

-- We do not believe other debtor nations will follow Peru's approach; debtors generally recognize the need to reach understandings with their creditors to assure continued access to financial markets. The go-it-alone approach cannot work for the larger debtors.

Senator DeConcini: Mexico got into international debt trouble in 1982 and last year. The Administration has put together extensive debt relief plans in both cases. Is the Administration planning -- or is it prepared -- to take any special steps to help in the future given its unique relationship with the U.S.?

Secretary Baker:

-- In 1982 and 1986, we provided Mexico with temporary liquidity through bridge financing from Treasury's Exchange Stabilization Fund.

-- Both times Mexico repaid Treasury and other bridge participants on a timely basis.

-- In addition, the United States participated in debt restructuring through the Paris Club.

-- These measures were not special in the sense that other countries have received similar treatment.

-- No appropriated funds have been used to assist Mexico, with the exception of oil purchases for the Strategic Petroleum Reserve.

-- Other assistance has been in the form of export credit guarantees from CCC and Eximbank.

-- We believe that existing forms of assistance are quite adequate and see no reason to devise other means of assisting Mexico in the future.

QUESTIONS SUBMITTED BY SENATOR WEICKER

Senator Weicker: Mr. Secretary, in your prepared remarks you state that "program basic to our national interest should be properly funded. Some -- like basic scientific research and the space program -- will help keep America strong as we prepare for the 21st Century."

Do you think we need good quality biomedical research to keep America strong?

Secretary Baker: Good quality biomedical research has contributed to America's strength in the past and the President's proposal will assure that it continues to do so by providing stable and sustainable support for ongoing and future biomedical research.

Senator Weicker: Do you think a commitment to the health of the American people is basic to our national interest?

Secretary Baker: Yes, a healthy America is both a more productive America, and a country where the quality of life of its citizens is enhanced.

Senator Weicker: Can you explain why the President has proposed cutting the funds for biomedical research in the Fiscal Year 1987 budget and the Fiscal Year 1988 budget? Can you explain why, if you add up the President's proposed cuts, the Administration would propose cutting the National Institutes of Health by more than $600 million?

Secretary Baker: Under the President's proposal the level of research spending for NIH in 1988 would be essentially unchanged from 1987. The budget proposal would shift the obligation of approximately $334 million form 1987 to 1988. The 1988 request also includes approximately $2.7 billion to cover outyear costs of new and competing research grants to be awarded by NIH in 1988. The funding of grants is now on an annual basis. This proposal would improve the management and planning of biomedical research grants supported by Federal funds. This would bring to around 19,100 the number of biomedical research grants supported by NIH, in 1987 and 1988 compared with 18,800 in 1986.

The 1988 spending level will be approximately $5.8 billion and will include the $334 million carryover from 1987. The 1987-88 two-year total for NIH biomedical research would be $11.6 billion, a nearly 12 percent increase over the previous two-year total of $10.4 billion, reflecting the Administration's commitment not only to biomedical research and its benefits for the American people, but also its commitment to the more efficient management of the large scale Federal contribution to the biomedical research enterprise.

Senator Weicker: I also notice in your prepared statement you highlight the issue of AIDS research.

Do you know the President proposes to increase AIDS research by only about $100 million but cuts the overall biomedical research budget by more the $600 million?

Secretary Baker: As noted earlier, under the President's proposal, the 1988 level of spending on biomedical research would be essentially unchanged from 1987, but with t he combined 1987-88 level representing a nearly 12 percent increase over the total for the previous two years. The acquired immune deficiency syndrome (AIDS) is the Administration's highest public health priority. The Administration is proposing $534 million for AIDS research and education programs. This is a 28 percent or $118 million increase over the 1987 level and more than twice the level for 1986. In addition, $98 million is proposed for use by the Veterans Administration and the Department of Defense to screen for the AIDs antibody and to counsel and provide medical care for veterans with AIDS.

Senator Weicker: And what about education, Mr. Secretary? Do you think an educated society is in our national interest? Can you tell me how it is in our national interest to cut the Federal education budget by $5.5 billion?

Secretary Baker: Of course an educated society is in the national interest, but one cannot equate the level of education in the he United States with the amount of Federal dollars spent. Education is primarily the responsibility of state and local governments, families and the private sector. Last year the Federal Government accounted for under 10 percent of education funding.

The Federal funding role is limited primarily to areas where the Federal responsibility is clear. For example, supplementary services for the disadvantaged and handicapped, assistance for the poor in post-secondary education and for high quality national level research and statistics.

Most of the cut in education funding is in student aid for higher education where the $4.5 million budget request in 1988 is $3.6 billion below the $8.1 billion enacted level for 1987. However, the Administration's proposal would provide about the same level of aid as is now available, but would substantially reduce the cost to the taxpayer, by reducing the amount of grants to higher income students and increasing resources for loans to students. Under the proposal for Pell Grants, aid would be available primarily to those with the greatest need, with virtually no students with income below the poverty line losing and Pell aid.

Any student losing aid could choose to offset the loss through increased borrowing under the Administration's proposal to make guaranteed, interest rate-capped loans available on a wide basis to cover education costs. Under the income contingent loan program, loan repayment provisions are made more manageable by tying repayments to earnings. The budget request for the income contingent loan program is increased from $5 million in 1987 to $600 million in 1988. The overall level of Federal education aid would be reduced from approximately $13.7 billion in 1986 to approximately $13.1 billion in 1988.

QUESTIONS SUBMITTED BY SENATOR D'AMATO

THE AIR INTERDICTION PROGRAM

Senator D'Amato: Can you assure us that all work on the various aspects of this program (including: Command, Communications, Control and Intelligence, modification of C-12's, operation and maintenance of the E-2C's the P-3 radar modification, and spare parts) is proceeding on schedule, and that this program will be fully operational by the end of this year?

Secretary Baker: Customs currently has contracts with three firms to provide designs for its core C-3I System. One firm will be selected in a design "flyoff"; a contract is expected in early May 1987.

The selected firm will be required to provide an Initial Operating Capability for C-3I Centers located at March AFB (Riverside, California), Coast Guard Communications Station Richmond Heights (Miami, Florida), and at a National Command Center by September 30, 1987.

Customs is researching expansion of this program to cover, in addition to the six C-12s, our five King Airs. Customs is also considering a tracker type sensor package incorporating infrared and acquisition radar. Contracts will be in place by the end of this year.

Customs will have four crews (8 pilots and 8 radar operators) fully qualified and operating two E-2C aircraft from Corpus Christi, Texas, by July 6, 1987.

Customs has not received the required AN/APS-138 radar system from DOD. As soon as the radar system has been received Lockheed has guaranteed an operational P-3B with an AN/APS-138 radar system installed and fully integrated in 17 months.

BUDGET CUTS

Senator D'Amato: Do you believe that reducing the Customs Service Budget by 12 percent--or $120 million--and 1,996 positions below current levels, won't Customs' ability to provide effective law enforcement and provide service to importers and exports by impaired?

Secretary Baker: Although Customs is proposing a significant staffing reduction, innovations implemented in recent years, specifically automation, reduced paperwork, and improved processing procedures, will, we believe, mitigate the impact upon commercial operations. Improved efficiency due to automation has reduced the need for large numbers of commercial processing staff. In addition, the impact on commercial operations will be mitigated by the further improvement to be implemented by FY 1988 in the Automated Commercial Systems (ACS). a significant program for extending automated processing is the Automated Broker Interface (ABI), which provides for an integrated computer interchange for processing entries. It eliminates redundant keying of data, normal manual preparation of import documentation, and the need for extensive back-up documentation. Other improvements for reducing staffing requirements are:

- improved selection methods for cargo and passenger inspections,
- extension of centralized inspectional examinations, and
- implementation of an audit inspection system.

With regard to enforcement, Customs will support its priority drug and other law enforcement programs. Customs will maintain Operation Alliance, its air and marine programs, and other enforcement efforts along the Southern border.

DRUG LAW ENFORCEMENT

Senator D'Amato: Can you provide us with a department estimate of how much of the proposed Customs Service budget for 1987 and 1988 is allocated to drug law enforcement? I would like to compare your estimates with the Congressional Research Service estimate that, although we appropriated $553 million for this year, the Administration proposes that we cut Customs drug law enforcement more than 23 percent, down to $425 million in 1988.

Secretary Baker: The FY 1987 proposed budget level includes $499.8 million for drug law enforcement, while the FY 1988 President's budget includes $426.6 million. These funding levels provide for strong interdiction, including continued support for the major multi-agency Operation Alliance initiative, increased hours of operation for air interdiction, improved air program detection and C3I centers, enhanced intelligence, and a variety of important support equipment. In FY 1987, the number of enforcement positions allocated to the Southwest Border has nearly doubled. Except for certain one-time, nonrecurring equipment level of resources dedicated to Operation Alliance in FY 1988 as in FY 1987.

The $553 million figure is based on erroneous assumptions. The $499.8 million figure corrects these errors. It includes the full amount of the FY 1987 Continuing Resolution for the air program.

THE CUSTOMS FORFEITURE FUND

Senator D'Amato: The budget cuts this fund by 44 percent from $18 million to $10 million. OMB says this reflects "The

nonrecurring costs of the FY 1987 Drug Interdiction Enforcement Act (P.L. 99-570)."

Specifically, what are these "nonrecurring" costs? What is nonrecurring about the purposes for which the Customs Service Forfeiture Fund is used? What is nonrecurring about investigative costs leading to seizures, or the costs of equipping Customs vehicles and aircraft for law enforcement purposes?

Secretary Baker: The FY 1987 Continuing Resolution provided $8 million in the regular appropriation (Title I) and $10 million for drug interdiction enforcement (Title II). The $10 million requested in FY 1988 actually represents an increase of $2 million over the $8 million provided for the regular appropriation in FY 1987. In addition, the Continuing Resolution expanded the uses of the fund to include investigativecosts leading to seizures, however, in the accompanying Conference Report, the uses of the $10 million provided for drug interdiction enforcement were limited to the original uses or for capital type enhancements only and could not be used for investigative costs. It was therefore assumed that this $10 million was nonrecurring in FY 1988.

USER FEES

Senator D'Amato: In the Custom s User Fee Receipts Account, OMB lists $417 million for 1987. Why does the budget proposal not ask that we appropriate any of that money this year?

If we did appropriate that amount, would not that eliminate the need to cut 1,485 positions this year from Customs Commercial Operations?

In addition to the $417 million expected for 1987, OMB lists $387 million in the Receipts Account for 1988. This means that OMB expects $804 million to be received through 1988. Yet OMB proposes appropriations of only $499 million for 1988.

What does OMB intend for the other $305 million?

Secretary Baker: At the time that the Customs FY 1988 budget was submitted to the Congress, there was a great deal of uncertainty on the amount to be collected for the Ad Valorem fees. A major problem in projecting receipts was the impact of importers switching to Schedule 8 imports, which the law exempts from the imposition of these fees. Because of the uncertainty, the decision was made to bypass FY 1987 and implement a separate Commercial Operations Activity program in FY 1988.

We believe that improved automation and work methods make the addition of staff by the Continuing Resolution unnecessary. With the failure of the proposed FY 1987 rescission, Customs intends to hire up to the Continuing

Resolution level. We continue to support a reduction from this level in FY 1988.

The amount proposed for FY 1988, represents the appropriations required to maintain Customs Commercial Operations Activity. This appropriation level would provide for the required staffing and services. The remaining $305 million will be held over to be used in FY 1989 for the Commercial Operations Activity.

REPEAT OFFENDER PROGRAM

Senator D'Amato: Can you tell us how many agents are involved in the Bureau of Alcohol, Tobacco and Firearms' Repeat Offender Program, how may career criminal cases they initiate in a year, and how many criminal defendants are involved in those cases?

Secretary Baker: The Continuing Resolution budget for FY 1987 provided ATF with specific funding for increased emphasis on programs aimed at the apprehension of armed career criminals. As a result, ATF initiated Program Achilles to meet its expanded enforcement responsibilities under the Comprehensive Crime Control Act of 1984, and the Gun Control Act of 1968 as amended. Eighteen of ATF's 22 Law Enforcement Districts have committed total of 100 special agents to this project. In each of the participating districts, ATF is working closely with Federal, State, and local law enforcement agencies and prosecutors to identify, apprehend, and convict criminals who meet the profile of an armed career criminal. To date, ATF has indicted 165 armed career criminals, convicted 96, and obtained enhanced sentencing on 21. On an annual basis these 100 agents will initiate 1089 criminal cases and recommend 512 criminal defendants for prosecution. As noted by these accomplishments, Project Achilles is a realistic and effective approach to curb the criminal misuse of firearms by armed career criminals.

Senator D'Amato: How many Repeat Offender Program agents positions would be eliminated if the proposed recision were to be accepted? Can you estimate how many career criminal cases that many agents could initiate in a year, and how many criminals might be involved in those cases?

Secretary Baker: If the proposed recision were accepted, all 100 Repeat Offender Program agents presently being utilized would be eliminated. On an annual basis these 100 agents could initiate 1089 criminal cases and recommend 512 defendants for prosecution. Studies have shown that these criminals would commit 2450 armed robberies, 3600 burglaries and 447,500 other serious crimes during the next five years.

The 1988 Presidential Campaign

Senator D'Amato: The proposed budget states that the cost of protecting 13 Presidential Candidates will be about $30 million. How is that consistent with the fact that in 1984 there were only 7 candidates, and the cost of protecting them was $23 million?

Secretary Baker: The actual cost of the FY 1984 portion of the 1984 Campaign was $20,890,000, which equates to $23,624,000 in 1988 dollars. (Based on annual CPI% increases) The $29,911,000 budgeted in FY 1988 is not consistent with the FY 1984 actual amount spend on candidates, as you might guess. If campaign activity becomes extraordinarily heavy, and all indicators point to a crowded race, the FY 1988 budget would be an inadequate source of funds. It should also be noted that the 1984 candidates were protected for an average of only 109 days, compared to a 164 day average in 1980. Therefore, further testimony to a light 1984 campaign is indicated. If the campaign field remains sparse, the 1988 Campaign/Nominee budget might be adequate. Projections, unfortunately, point towards a large field and trends indicate travel will be substantial.

Funding Requirements

Senator D'Amato: Assuming the $24 million increase for Campaign security is sufficient, and the $41 million budget increase in 1988, the Service is left with $17 million that becomes available for other needs. The new retirement system will cost approximately $12 million. How will the remaining $5 million enable the Secret Service to maintain current performance levels, keep up with inflation, and cover the cost of the recent three percent pay raise?

Secretary Baker: Available funding will not allow the Service to maintain current operational levels, fund the three percent pay increase, fund FERS, and fund inflationary increases. The inflationary costs excluding FERS and the pay raise alone will require $15 million. The pay increase will cost an additional $6.6 million and FERS will require $18.3 million. Without sufficient funding to cover these mandatory costs, the Service's programs will have to be reduced accordingly.

FEDERAL LAW ENFORCEMENT TRAINING CENTER

Senator D'Amato: The Budget proposes a rescission of $8,450,000 for the Training Center in 1987. Although this rescission will not be approved, and the money will become available by the middle of March, there are already signs that this rescission has forced a slowdown in the Center's ability to train federal law enforcement personnel. What effect is the rescission having this year on anti-terrorism and drug law enforcement training?

Secretary Baker: With respect to the question of anti-terrorism training, the Federal Law Enforcement Training Center formed a special faculty unit to develop plans for this training at its Glynco, Georgia, site. In FY 86 and early '87 this unit worked closely with each of the Center's participating agencies and with the US Intelligence Community in order to devise specific instructional areas and materials. As a result of this action, the Center proposed a four prong approach to meet the training needs of its clientele agencies. This involves adding instructional hours to each basic program for federal officers and agents to address this subject and the development of three separate journeymen level programs to deal with physical security, incident containment, and anti-terrorism management. In FY87, the Center has conducted pilots in tow basic programs. Other programs are projected to be piloted in late FY87 or FY88, but development has been slowed pending the availability of funds.

The Center's FY 1987 Continuing Resolution contains a provision for $150,000 to be used in support of drug enforcement efforts. That money is being used by the Center' Office of State and Local training to help develop training modules which will address the major elements of drug interdiction training for State and local law enforcement officers. Principally, this training will be done to support Operation Alliance along the Southwest Border. The Center now is exploring various through train-the-trainer concept, video tapes, discussion guides, and other training aids. Any further development or delivery of training for either State and local officers or federal personnel will be dependent upon additional funds being available.

THE AIR INTERDICTION PROGRAM

Senator D'Amato: There has been some confusion about the Customs Service's ability to spend the full amount for the air program that we appropriated. Can you look into this, and report back whether there has been any attempt to hold up the obligation or spending of these funds?

Secretary Baker: Customs is continuing with all programs and fully expects to obligate all of these funds for the programs intended.

We asked Customs in mid-December 1986 not to obligate the funds for the P3 aircraft modification until

January 1987, when Drug Policy Board would review the project. The Board approved the project, and we indicated to Customs that it should proceed as planned. This did not result in a delay of the project, as Customs does not contemplate beginning the modification until July 1987.

The funds for all projects have been legally available to Customs through the Apportionment process since December 5, 1986.

SUBCOMMITTEE RECESS

Chairman STENNIS. We want to thank you very much for the attention you have given this matter. It has no exact beginning nor ending, either, but it is a tremendous problem at the same time. Much of it goes along with our system of Government. We have to find solutions to these things, and we appreciate your attitude and your help and wish you well in every way.

Is there anything else you can think of now? All right. Thank you very much.

Secretary BAKER. Thank you, Mr. Chairman.

Chairman STENNIS. Is there any other matter here to come before the committee?

The committee will stand in recess subject to the call of the Chair.

Thank you, again.

[Whereupon, at 11:40 a.m., Thursday, February 26, the committee was recessed, to reconvene at the call of the Chair.]

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